



# Income Tax Assessment Act 1997

No. 38, 1997

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This compilation is in 12 volumes

Volume 1: sections 1-1 to 36-55  
Volume 2: sections 40-1 to 67-30  
Volume 3: sections 70-1 to 121-35  
Volume 4: sections 122-1 to 197-85  
Volume 5: sections 200-1 to 253-15  
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Volume 7: sections 315-1 to 420-70  
Volume 8: sections 615-1 to 721-40  
**Volume 9: sections 723-1 to 880-205**  
Volume 10: sections 900-1 to 995-1  
Volume 11: Endnotes 1 to 3  
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Each volume has its own contents

**This compilation includes commenced amendments made by Act No. 14, 2023. Amendments made by Act No. 15, 2023 have not commenced but are noted in the endnotes.**

Prepared by the Office of Parliamentary Counsel, Canberra

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## About this compilation

### This compilation

This is a compilation of the *Income Tax Assessment Act 1997* that shows the text of the law as amended and in force on 12 April 2023 (the **compilation date**).

The notes at the end of this compilation (the **endnotes**) include information about amending laws and the amendment history of provisions of the compiled law.

### Uncommenced amendments

The effect of uncommenced amendments is not shown in the text of the compiled law. Any uncommenced amendments affecting the law are accessible on the Legislation Register ([www.legislation.gov.au](http://www.legislation.gov.au)). The details of amendments made up to, but not commenced at, the compilation date are underlined in the endnotes. For more information on any uncommenced amendments, see the series page on the Legislation Register for the compiled law.

### Application, saving and transitional provisions for provisions and amendments

If the operation of a provision or amendment of the compiled law is affected by an application, saving or transitional provision that is not included in this compilation, details are included in the endnotes.

### Editorial changes

For more information about any editorial changes made in this compilation, see the endnotes.

### Modifications

If the compiled law is modified by another law, the compiled law operates as modified but the modification does not amend the text of the law. Accordingly, this compilation does not show the text of the compiled law as modified. For more information on any modifications, see the series page on the Legislation Register for the compiled law.

### Self-repealing provisions

If a provision of the compiled law has been repealed in accordance with a provision of the law, details are included in the endnotes.

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## **Chapter 3—Specialist liability rules**

### **Part 3-95—Value shifting**

#### **Division 723—Direct value shifting by creating right over non-depreciating asset**

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##### **723-1 Object**

The purpose of this Division is to reduce a loss that would otherwise be \*realised for income tax purposes by a \*realisation event happening to an asset (except a \*depreciating asset), to the extent that:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) value has been shifted out of the asset by the owner creating in an associate a right over the asset; and
- (b) the value shifted was not brought to tax when the right was created and has not since been brought to tax on a realisation of the right.

**723-10 Reduction in loss from realising non-depreciating asset over which right has been created**

- (1) A loss that would, apart from this Division, be \*realised for income tax purposes by a \*realisation event is reduced by the amount worked out under subsections (3) and (4) if:
  - (a) the event happens to a \*CGT asset (the *underlying asset*) you own that, at the time of the event (the *realisation time*):
    - (i) is *not* a \*depreciating asset; or
    - (ii) is an item of your \*trading stock; or
    - (iii) is a \*revenue asset of yours; and
  - (b) before the realisation time:
    - (i) you created in an \*associate of yours; or
    - (ii) an entity covered by subsection (2) (about previous owners of the underlying asset) created in an associate of the entity;a right in respect of the underlying asset; and
  - (c) immediately before the realisation time, the right is still in existence and is owned by an associate of yours; and
  - (d) a decrease in the underlying asset's \*market value is reasonably attributable to the creating of the right; and
  - (e) creating the right involved a \*CGT event:
    - (i) whose \*capital proceeds are *less* than the market value of the right when created (the difference between those capital proceeds and that market value is called the *shortfall on creating the right*); and
    - (ii) that is *not* a CGT event that happens to some part of the underlying asset but not to the remainder of it; and
  - (f) the shortfall on creating the right is more than \$50,000; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (g) the market value of the underlying asset at the realisation time is less than it would have been if the right no longer existed at that time (the difference is called the ***deficit on realisation***).

Note: If subparagraph (1)(e)(ii) applies, the cost base and reduced cost base of the underlying asset is apportioned under section 112-30, so there is no need for this section to apply to the right.

- (2) This subsection covers an entity if:
- (a) the entity \*acquired the underlying asset before you did; and
  - (b) there has been a roll-over for each \*CGT event (if any) as a result of which an entity (including you) acquired the asset after the first entity acquired it, and before the realisation time; and
  - (c) for each such CGT event (if any), the entity (including you) that acquired the underlying asset as a result of the event was, immediately after the event, an \*associate of the entity that last acquired the asset before the event.
- (3) The amount by which this section reduces the loss is the lesser of:
- (a) the shortfall on creating the right; and
  - (b) the deficit on realisation.

However, that amount is reduced by each gain that:

- (c) is \*realised for income tax purposes by a \*realisation event that happens to the right:
  - (i) before or at the realisation time for the underlying asset; and
  - (ii) at a time when the right is owned by an entity that is your \*associate immediately before the realisation time for the underlying asset; and
- (d) is not disregarded.

Note: To work out a gain realised for income tax purposes by a realisation event that happens to the right, see sections 977-15, 977-35, 977-40 and 977-55. If more than one of those sections applies to the right, see section 723-50.

- (4) For each gain that:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) is \*realised for income tax purposes by a \*realisation event that happens to the right:
    - (i) within 4 years after the realisation time for the underlying asset; and
    - (ii) at a time when the right is owned by an entity that is your \*associate immediately before the realisation time for the underlying asset; and
  - (b) is not disregarded;
- the amount worked out under subsection (3) is taken to have been reduced by the amount of that gain.

Note: This subsection may result in amendment of an assessment for the income year in which the realisation time happens.

**723-15 Reduction in loss from realising non-depreciating asset at the same time as right is created over it**

- (1) A loss that would, apart from this Division, be \*realised for income tax purposes by a \*realisation event is reduced by the amount worked out under subsections (2) and (3) if:
  - (a) the event happens to a \*CGT asset (the *underlying asset*) you own that, at the time of the event (the *realisation time*):
    - (i) is *not* a \*depreciating asset; or
    - (ii) is an item of your \*trading stock;
    - (iii) is a \*revenue asset of yours; and
  - (b) at the realisation time, you create in an \*associate of yours a right in respect of the underlying asset; and
  - (c) creating the right involves a \*CGT event:
    - (i) whose \*capital proceeds are *less* than the \*market value of the right when created (the difference between those capital proceeds and that market value is called the *shortfall on creating the right*); and
    - (ii) that is *not* a CGT event that happens to some part of the underlying asset but not to the remainder of it; and
  - (d) the shortfall on creating the right is more than \$50,000; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (e) the market value of the underlying asset at the realisation time is less than it would have been if the right had not been created (the difference is called the *deficit on realisation*).

Note: If subparagraph (1)(c)(ii) applies, the cost base and reduced cost base of the underlying asset is apportioned under section 112-30, so there is no need for this section to apply to the right.

- (2) The amount by which this section reduces the loss is the lesser of:
  - (a) the shortfall on creating the right; and
  - (b) the deficit on realisation.
- (3) For each gain that:
  - (a) is \*realised for income tax purposes by a \*realisation event that happens to the right:
    - (i) within 4 years after the realisation time for the underlying asset; and
    - (ii) at a time when the right is owned by an entity that is your \*associate immediately before the realisation time for the underlying asset; and
  - (b) is not disregarded;the amount worked out under subsection (2) is taken to have been reduced by the amount of that gain.

Note 1: To work out a gain realised for income tax purposes by a realisation event that happens to the right, see sections 977-15, 977-35, 977-40 and 977-55. If more than one of those sections applies to the right, see section 723-50.

Note 2: This subsection may require amendment of an assessment for the income year in which the realisation time happens.

## 723-20 Exceptions

### *Conservation covenant over land*

- (1) Section 723-10 or 723-15 does not reduce a loss if:
  - (a) the underlying asset is land; and
  - (b) the right referred to in paragraph 723-10(1)(b) or 723-15(1)(b) is a \*conservation covenant over the land.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 723-25

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*Right created on death of owner*

- (2) Section 723-10 or 723-15 does not reduce a loss if the right referred to in paragraph 723-10(1)(b) or 723-15(1)(b) is created by:
- (a) a will or codicil; or
  - (b) an order of a court varying or modifying a will or codicil; or
  - (c) a total or partial intestacy; or
  - (d) an order of a court varying or modifying the application of the law about distributing the estate of someone who dies intestate.

**723-25 Realisation event that is only a partial realisation**

- (1) Section 723-10 or 723-15 applies differently if:
- (a) a \*realisation event happens to some part of a \*CGT asset (the ***underlying asset***) you own that, at the time of the event:
    - (i) is *not* a \*depreciating asset; or
    - (ii) is an item of your \*trading stock; or
    - (iii) is a \*revenue asset of yours;but not to the remainder of the underlying asset; or
  - (b) a realisation event consists of creating an interest in a CGT asset (also the ***underlying asset***) you own that, at the time of the event, is covered by subparagraph (a)(i), (ii) or (iii).
- (2) The section applies on the basis that:
- (a) the \*realisation event happens to the underlying asset; and
  - (b) the shortfall on creating the right referred to in paragraph 723-10(1)(e) or 723-15(1)(c); and
  - (c) the deficit on realisation referred to in paragraph 723-10(1)(g) or 723-15(1)(e);
- are each reduced by multiplying its amount by this fraction:

$$\frac{\text{*Market value of part}}{\text{*Market value of underlying asset}}$$

- (3) For the purposes of the formula in subsection (2):

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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***market value of part*** means the \*market value, at the time of the \*realisation event, of the part referred to in paragraph (1)(a) or the interest referred to in paragraph (1)(b), as appropriate.

***market value of underlying asset*** means the \*market value, immediately before the \*realisation event, of the underlying asset.

### **723-35 Multiple rights created to take advantage of the \$50,000 threshold**

- (1) Sections 723-10 and 723-15 apply differently if, having regard to all relevant circumstances, it is reasonable to conclude that the sole or main reason why a right was created as a different right from one or more other rights created in respect of the same thing was so that paragraph 723-10(1)(f) or 723-15(1)(d) would not be satisfied for one or more of the rights mentioned in this subsection.
- (2) Those sections:
  - (a) apply to that thing, in relation to each of the rights mentioned in subsection (1) of this section, as if paragraphs 723-10(1)(f) and 723-15(1)(d) were omitted; and
  - (b) are taken always to have so applied.

### **723-40 Application to CGT asset that is also trading stock or revenue asset**

If a \*CGT asset you own is also an item of your \*trading stock or a \*revenue asset, this Division applies to the asset once in its character as a CGT asset and again in its character as trading stock or a revenue asset.

### **723-50 Effects if right created over underlying asset is also trading stock or a revenue asset**

- (1) Subsection 723-10(3) or (4) or 723-15(3) applies differently if the right created in respect of the underlying asset is also \*trading stock or a \*revenue asset at the time of a \*realisation event that happens to the right.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (2) The gain that is taken into account for the purposes of that subsection is:
- (a) if the right is also \*trading stock—worked out under section 977-35 or 977-40 (about realisation events for trading stock); or
  - (b) if the right is also a \*revenue asset—the greater of:
    - (i) the gain worked out under section 977-15 (about realisation events for CGT assets); and
    - (ii) the gain worked out under section 977-55 (about realisation events for revenue assets).

**Subdivision 723-B—Reducing reduced cost base of interests in entity that acquires non-depreciating asset under roll-over**

**Table of sections**

723-105	Reduced cost base of interest reduced when interest realised at a loss
723-110	Direct and indirect roll-over replacement for underlying asset

**723-105 Reduced cost base of interest reduced when interest realised at a loss**

- (1) The \*reduced cost base of a \*primary equity interest, \*secondary equity interest, or \*indirect primary equity interest, in a company or trust is reduced just before a \*realisation event that is a \*CGT event happens to the interest if:
- (a) apart from this Division, a loss would be \*realised for income tax purposes by the CGT event; and
  - (b) apart from this Division, a loss would have been \*realised for income tax purposes by a realisation event if the event had happened, just before the CGT event, to a \*CGT asset (the ***underlying asset***) that the company or trust then owned and that:
    - (i) was *not* then a \*depreciating asset; or
    - (ii) was then an item of \*trading stock of the company or trust; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (iii) was then a \*revenue asset of the company or trust; and
  - (c) the loss referred to in paragraph (b) would have been reduced under Subdivision 723-A by an amount (the ***underlying asset loss reduction***); and
  - (d) for the entity (the ***transferor***) that owned the interest just before the CGT event, the interest was a \*direct roll-over replacement or \*indirect roll-over replacement for the underlying asset.
- (2) If the interest was a \*direct roll-over replacement, its \*reduced cost base is reduced by the amount worked out using this formula, unless that amount does not appropriately reflect the matters referred to in subsection (4):

$$\frac{\text{RCB of interest}}{\text{Total of RCBs of direct roll-over replacements}} \times \text{Underlying asset loss reduction}$$

- (3) For the purposes of the formula in subsection (2):

***RCB of interest*** means the interest's \*reduced cost base when the transferor \*acquired it.

***total of RCBs of direct roll-over replacements*** means the total of the \*reduced cost bases of all \*direct roll-over replacements for the underlying asset when the transferor \*acquired them.

- (4) If:
- (a) the interest was an \*indirect roll-over replacement; or
  - (b) the amount worked out under subsection (2) does not appropriately reflect the matters referred to in this subsection;
- the interest's \*reduced cost base is reduced by an amount that is appropriate having regard to these matters:
- (c) the underlying asset loss reduction; and
  - (d) the quantum of the interest relative to all \*direct roll-over replacements and indirect roll-over replacements that the transferor owns or has previously owned.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 723-110

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**723-110 Direct and indirect roll-over replacement for underlying asset**

- (1) For an entity (the *transferor*) that owns a \*CGT asset, the CGT asset is a **direct roll-over replacement** for something (the **underlying asset**) that another entity owns if, and only if:
  - (a) a \*CGT event happened to the underlying asset while the transferor owned it; and
  - (b) the other entity \*acquired the underlying asset as a result of that CGT event; and
  - (c) there was a \*replacement-asset roll-over for the CGT event; and
  - (d) the transferor received the CGT asset (or CGT assets including it) in respect of the CGT event as the replacement asset (or the replacement assets).
- (2) For an entity (the *transferor*) that owns a \*CGT asset, the CGT asset is an **indirect roll-over replacement** for something (the **underlying asset**) that another entity owns if, and only if:
  - (a) a \*CGT event happened to another CGT asset at a time when the transferor owned it and the other entity already owned the underlying asset; and
  - (b) for the transferor, the other CGT asset was at that time:
    - (i) a \*direct roll-over replacement for the underlying asset; or
    - (ii) an indirect roll-over replacement for the underlying asset because of any other application or applications of this subsection; and
  - (c) there was a \*replacement-asset roll-over for the CGT event; and
  - (d) the transferor received the first CGT asset (or CGT assets including it) in respect of the CGT event as the replacement asset (or the replacement assets).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Division 725—Direct value shifting affecting interests in companies and trusts**

### **Table of Subdivisions**

	Guide to Division 725
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725-B	What is a direct value shift
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725-D	Consequences for down interest or up interest as CGT asset
725-E	Consequences for down interest or up interest as trading stock or a revenue asset
725-F	Value adjustments and taxed gains

### **Guide to Division 725**

#### **725-1 What this Division is about**

If, under a scheme, value is shifted from equity or loan interests in a company or trust to other equity or loan interests in the same company or trust (including interests issued at a discount), this Division:

- (a) adjusts the value of those interests for income tax purposes to take account of material changes in market value that are attributable to the value shift; and
- (b) treats the value shift as a partial realisation to the extent that value is shifted between interests held by different owners, and in some other cases.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 725-45**

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However, it does so only for interests that are owned by entities involved in the value shift.

**Subdivision 725-A—Scope of the direct value shifting rules**

**Table of sections**

725-45	Main object
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725-55	Controlling entity test
725-65	Cause of the value shift
725-70	Consequences for down interest only if there is a material decrease in its market value
725-80	Who is an affected owner of a down interest?
725-85	Who is an affected owner of an up interest?
725-90	Direct value shift that will be reversed
725-95	Direct value shift resulting from reversal

**725-45 Main object**

- (1) The main object of this Division is:
  - (a) to prevent inappropriate losses from arising on the realisation of \*equity or loan interests from which value has been shifted to other equity or loan interests in the same entity; and
  - (b) to prevent inappropriate gains from arising on the realisation of equity or loan interests in the same entity to which the value has been shifted;so far as those interests are owned by entities involved in the value shift.
- (2) This is done by:
  - (a) adjusting the value of those interests for income tax purposes to take account of changes in \*market value that are attributable to the value shift; and
  - (b) treating the value shift as a partial realisation to the extent that value is shifted:
    - (i) between interests held by different owners; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) in the case of interests in their character as CGT assets—from post-CGT assets to pre-CGT assets; or
- (iii) between interests of different characters.

### **725-50 When a direct value shift has consequences under this Division**

A \*direct value shift under a \*scheme involving \*equity or loan interests in an entity (the **target entity**) has consequences for you under this Division if, and only if:

- (a) the target entity is a company or trust at some time during the \*scheme period; and
- (b) section 725-55 (Controlling entity test) is satisfied; and
- (c) section 725-65 (Cause of the value shift) is satisfied; and
- (d) you are an \*affected owner of a \*down interest, or an \*affected owner of an \*up interest, or both; and
- (e) neither of sections 725-90 and 725-95 (about direct value shifts that are reversed) applies.

Note: For a down interest of which you are an affected owner, the direct value shift has consequences under this Division only if section 725-70 (about material decrease in market value) is satisfied.

### **725-55 Controlling entity test**

An entity (the **controller**) must \*control (for value shifting purposes) the target entity at some time during the period starting when the \*scheme is entered into and ending when it has been carried out. (That period is the **scheme period**.)

For the concept of **control (for value shifting purposes)**, see sections 727-355 to 727-375.

### **725-65 Cause of the value shift**

- (1) It must be the case that one or more of the following:
  - (a) the target entity;
  - (b) the controller;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-65

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- (c) an entity that was an \*associate of the controller at some time during or after the \*scheme period;
  - (d) an \*active participant in the \*scheme;
- (either alone or together with one or more other entities) did under the scheme the one or more things:
- (e) to which the decrease in the \*market value of the \*down interests is reasonably attributable; and
  - (f) to which the increase in the market value of the \*up interests, or the issue of up interests at a \*discount, is reasonably attributable, or that is or include the issue of up interests at a \*discount.

*Active participants (if target entity is closely held)*

- (2) An entity (the **first entity**) is an **active participant** in the \*scheme if, and only if:
  - (a) at some time during the \*scheme period, the target entity has fewer than 300 members (in the case of a company) or fewer than 300 beneficiaries (in the case of a trust); and
  - (b) the first entity has actively participated in, or directly facilitated, the entering into or carrying out of the \*scheme (whether or not it did so at the direction of some other entity); and
  - (c) the first entity:
    - (i) owns a \*down interest at the \*decrease time; or
    - (ii) owns an \*up interest at the \*increase time or has an up interest issued to it at a \*discount because of the \*direct value shift.

*When an entity has 300 or more members or beneficiaries*

- (3) Section 124-810 (under which certain companies and trusts are not regarded as having 300 or more members or beneficiaries) also applies for the purposes of this Division.
- (4) In addition, this Division applies to a \*non-fixed trust as if it did not have 300 or more beneficiaries.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**725-70 Consequences for down interest only if there is a material decrease in its market value**

- (1) For a \*down interest of which you are an \*affected owner, the \*direct value shift has consequences under this Division only if the sum of the decreases in the \*market value of all down interests because of direct value shifts under the same \*scheme as the direct value shift is at least \$150,000.

Note: In working out the sum of the decreases in market value of all down interests, it will be necessary to include decreases not only in your down interests, but also in those of other affected owners and of entities that are not affected owners.

- (2) However, if, having regard to all relevant circumstances, it is reasonable to conclude that the sole or main reason why a \*direct value shift happened under a different scheme from one or more other direct value shifts was so that subsection (1) would not be satisfied for one or more of the direct value shifts mentioned in this subsection, subsection (1) does not apply (and is taken never to have applied) to any of the direct value shifts.

**725-80 Who is an affected owner of a down interest?**

An entity is an *affected owner* of a \*down interest if, and only if, the entity owns the down interest at the \*decrease time and at least one of these paragraphs is satisfied:

- (a) the entity is the controller;
- (b) the entity was an \*associate of the controller at some time during or after the \*scheme period;
- (c) the entity is an \*active participant in the \*scheme.

**725-85 Who is an affected owner of an up interest?**

An entity is an *affected owner* of an \*up interest if, and only if:

- (a) there is at least one \*affected owner of \*down interests; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 725-90**

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- (b) the entity owns the up interest at the \*increase time, or the interest is an up interest because it was issued to the entity at a \*discount;
- and at least one of these paragraphs is satisfied:
- (c) the entity is the controller;
  - (d) the entity was an \*associate of the controller at some time during or after the \*scheme period;
  - (e) at some time during or after the scheme period, the entity was an associate of an entity that is an affected owner of down interests because it was an associate of the controller at some time during or after that period;
  - (f) the entity is an \*active participant in the \*scheme.

**725-90 Direct value shift that will be reversed**

- (1) The \*direct value shift does *not* have consequences for you under this Division if:
    - (a) the one or more things referred to in paragraph 725-145(1)(b) brought about a state of affairs, but for which the direct value shift would not have happened; and
    - (b) as at the time referred to in that paragraph, it is more likely than not that, because of the \*scheme, that state of affairs will cease to exist within 4 years after that time.
- Example: Under a scheme, the voting rights attached to a class of shares in a company are changed. As a result, the market value of shares in that class decreases, and the market value of other classes of shares in the company increases. The company's constitution provides that the change is to last for only 3 years.
- (2) However, this section stops applying if the state of affairs referred to in paragraph (1)(a) still exists:
    - (a) at the end of those 4 years; or
    - (b) when a \*realisation event happens to \*down interests or \*up interests of which you are, or any other entity is, an \*affected owner;
- whichever happens sooner.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (3) If this section stops applying, it is taken *never* to have applied to the \*direct value shift.

Note: This may result in an assessment for an earlier income year having to be amended to give effect to the consequences that the direct value shift would have had for you under this Division if this section hadn't applied.

### **725-95 Direct value shift resulting from reversal**

- (1) A \*direct value shift does not have consequences for any entity under this Division if:
- (a) section 725-90 applies, and the state of affairs referred to in paragraph 725-90(1)(a) ceases to exist; and
  - (b) the direct value shift would not have happened but for that state of affairs ceasing to exist.
- (2) However, if section 725-90 stops applying, this section is taken *never* to have applied to the later direct value shift.

### **Subdivision 725-B—What is a direct value shift**

#### **Table of sections**

725-145	When there is a <i>direct value shift</i>
725-150	Issue of equity or loan interests at a <i>discount</i>
725-155	Meaning of <i>down interests</i> , <i>decrease time</i> , <i>up interests</i> and <i>increase time</i>
725-160	What is the nature of a direct value shift?
725-165	If market value decrease or increase is only partly attributable to the scheme

### **725-145 When there is a direct value shift**

- (1) There is a *direct value shift* under a \*scheme involving \*equity or loan interests in an entity (the *target entity*) if:
- (a) there is a decrease in the \*market value of one or more equity or loan interests in the target entity; and
  - (b) the decrease is reasonably attributable to one or more things done under the scheme, and occurs at or after the time when that thing, or the first of those things, is done; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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(c) either or both of subsections (2) and (3) are satisfied.

Examples of something done under a scheme are issuing new shares at a \*discount, buying back shares or changing the voting rights attached to shares.

- (2) One or more \*equity or loan interests in the target entity must be issued at a \*discount. The issue must be, or must be reasonably attributable to, the thing, or one or more of the things, referred to in paragraph (1)(b). It must also occur at or after the time referred to in that paragraph.

Example: A company runs a family business. There are 2 shares originally issued for \$2 each. They are owned by husband and wife. The market value of the shares is much greater (represented by the value of the assets of the company less its liabilities). The company issues one more share for \$2 to their son.

Caution is needed in such a situation. The example would result in a large CGT liability for the husband and wife under this Division, because they have shifted 1/3 of the value of their own shares to their son. No such liability would arise if the share had been issued for its market value.

- (3) Or, there must be an increase in the \*market value of one or more \*equity or loan interests in the target entity. The increase must be reasonably attributable to the thing, or to one or more of the things, referred to in paragraph (1)(b). It must also occur at or after the time referred to in that paragraph.

**725-150 Issue of equity or loan interests at a *discount***

- (1) An \*equity or loan interest is issued at a ***discount*** if, and only if, the \*market value of the interest when issued exceeds the amount of the payment that the issuing entity receives. The excess is the amount of the ***discount***.
- (2) The payment that the issuing entity receives can include property. If it does, use the \*market value of the property in working out the amount of the payment.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

*Amounts for which bonus equities are treated as being issued*

- (3) If:
- (a) a \*primary equity interest is issued as mentioned in subsection 130-20(1) (about bonus equities issued in relation to original equities); and
  - (b) subsection 130-20(3) does *not* apply (about bonus equities that are a dividend or otherwise assessable income);
- subsection (1) of this section applies to the interest as if the amount of the payment that the issuing entity receives were equal to the \*cost base of the interest when issued (as worked out under section 130-20).
- (4) If:
- (a) a \*primary equity interest is issued as mentioned in subsection 6BA(1) of the *Income Tax Assessment Act 1936* (about bonus shares issued in relation to original shares); and
  - (b) subsection 6BA(2) of that Act applies (about bonus shares that are a dividend);
- subsection (1) of this section applies to the interest as if the amount of the payment that the issuing entity receives were equal to the consideration worked out under subsection 6BA(2) of that Act.
- (5) If both of subsections (3) and (4) apply to the issue of the same \*primary equity interest, subsection (1) of this section applies to the interest as if the amount of the payment that the issuing entity receives were equal to the greater of the amounts worked out under subsections (3) and (4).

*Application of subsections (3), (4) and (5)*

- (6) Subsection (3) does not apply if, for the income year in which the interest is issued, the issuing entity is a public trading trust within the meaning of section 102R of the *Income Tax Assessment Act 1936*.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 725-155

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- (7) Subsections (3), (4) and (5) have effect only for the purposes of working out whether a \*direct value shift has happened and, if so, its consequences (if any) under this Division.

**725-155 Meaning of *down interests*, *decrease time*, *up interests* and *increase time***

- (1) An \*equity or loan interest in the target entity is a ***down interest*** if a decrease in its \*market value is reasonably attributable to the one or more things referred to in paragraph 725-145(1)(b), and occurs at or after the time referred to in that paragraph. The time when the decrease happens is called the ***decrease time*** for that interest.
- (2) An \*equity or loan interest in the target entity is an ***up interest*** if subsection 725-145(2) or (3) is satisfied for the interest. The time when the interest is issued at a \*discount, or the increase in \*market value happens, is called the ***increase time*** for that interest.

**725-160 What is the nature of a direct value shift?**

- (1) The \*direct value shift has 2 aspects.
- (2) Overall, it consists of:
- (a) the decreases in \*market value of the down interests; and
  - (b) the issue at a \*discount of the up interests covered by subsection 725-145(2); and
  - (c) the increases in market value of the up interests covered by subsection 725-145(3).
- (3) This Division also proceeds on the basis that the \*direct value shift is from *each* of the \*down interests to *each* of the \*up interests.

**725-165 If market value decrease or increase is only partly attributable to the scheme**

If it is reasonable to conclude that an increase or decrease in \*market value, or the issuing of an \*equity or loan interest at a \*discount, is only partly caused by the doing of the one or more

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

things under the \*scheme, this Division applies to the increase, decrease, or issue at a discount, to that extent only.

## **Subdivision 725-C—Consequences of a direct value shift**

### **Table of sections**

#### **General**

- 725-205 Consequences depend on character of down interests and up interests  
725-210 Consequences for down interests depend on pre-shift gains and losses

#### **Special cases**

- 725-220 Neutral direct value shifts  
725-225 Issue of bonus shares or units  
725-230 Off-market buy-backs

### **General**

#### **725-205 Consequences depend on character of down interests and up interests**

- (1) The consequences for you of the \*direct value shift depend on the character of the \*down interests and \*up interests of which you are an \*affected owner.
- (2) There are consequences for all your \*down interests and \*up interests in their character as \*CGT assets. However, some of them may also be \*trading stock or \*revenue assets. There are additional consequences for those interests in their character as trading stock or revenue assets.

Note: For example, you may own a down interest that is a CGT asset and a revenue asset.

Sections 725-240 to 725-255 set out the consequences for you of a shift in value from that interest in its character as a CGT asset. The cost base of the asset will be decreased, which will affect the calculation of a capital gain when a CGT event happens to the interest.

Section 725-320 sets out the consequences for you of a shift in value from that interest in its character as a revenue asset. The adjustment

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 725-210

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made under that section will affect the calculation of any profit on the sale of the interest.

Any overlap between the capital gain and the profit realised on the sale of the interest is then dealt with under section 118-20.

In some instances, the direct value shift may result in a taxing event generating a gain for you in the income year in which the shift happens. That gain will be both a capital gain (because the down interest can be characterised as a CGT asset) and an increase in your assessable income (because the down interest can be characterised as a revenue asset). Again, any overlap is dealt with under section 118-20.

### 725-210 Consequences for down interests depend on pre-shift gains and losses

- (1) The consequences for a \*down interest also depend on whether it has a \*pre-shift gain or a \*pre-shift loss.
- (2) It has a ***pre-shift gain*** if, immediately before the \*decrease time, its \*market value was *greater than* its \*adjustable value.
- (3) It has a ***pre-shift loss*** if, immediately before the \*decrease time, its \*market value was *equal to or less than* its \*adjustable value.

### Special cases

#### 725-220 Neutral direct value shifts

- (1) The consequences are different if the total decrease in \*market value of your \*down interests is equal to the sum of:
  - (a) the total increase in market value of your \*up interests; and
  - (b) the total \*discounts given to you on the issue of your up interests.
- (2) In that case, this Subdivision and Subdivisions 725-D to 725-F apply to you as if the \*direct value shift:
  - (a) consisted only of:
    - (i) the decreases in \*market value of your \*down interests; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) the issue at a \*discount of your \*up interests covered by subsection 725-145(2); and
    - (iii) the increases in market value of your up interests covered by subsection 725-145(3); and
  - (b) were from each of your down interests to each of your up interests.
- (3) This section has effect despite section 725-160.

### **725-225 Issue of bonus shares or units**

- (1) The consequences are different if you are an \*affected owner of \*up interests (the ***bonus interests***) that the target entity issues to you, at a \*discount, under the \*scheme, in relation to \*down interests (the ***original interests***) of which you are an affected owner.

#### *Effect of treatment under subsection 130-20(3)*

- (2) To the extent that the \*direct value shift is *to* the bonus interests *from* original interests in relation to which the target entity issued bonus interests to which:
- (a) subsection 130-20(3) applies (because none of them is a dividend or otherwise assessable income); and
  - (b) item 1 of the table in that subsection applies (because the original interests are post-CGT assets);
- these paragraphs apply:
- (c) the respective \*cost bases and \*reduced cost bases of those original interests are not reduced;
  - (d) the bonus interests referred to in subsection (1) do not give rise to a \*taxing event generating a gain for you under the table in section 725-245 on any of those original interests.
- (3) To the extent that the \*direct value shift is *from* the original interests *to* bonus interests to which subsection 130-20(3) applies (because none of them is a dividend or otherwise assessable income) and:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-230

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- (a) item 1 of the table in that subsection applies (because the original interests are post-CGT assets); or
- (b) item 2 of that table applies (because the original interests are pre-CGT assets and an amount has been paid for the bonus interests that you were required to pay);

the respective \*cost bases and \*reduced cost bases of those bonus interests are not uplifted.

*Effect of treatment under subsection 6BA(3) of the Income Tax Assessment Act 1936*

- (4) To the extent that the \*direct value shift is *to* the bonus interests *from* original interests in relation to which the target entity issued bonus interests to which subsection 6BA(3) of the *Income Tax Assessment Act 1936* applies (either because they are shares issued for no consideration and none of them is a dividend or because they qualify for the intercorporate dividend rebate):
  - (a) the respective \*adjustable values of those original interests, in their character as \*trading stock or \*revenue assets, are not reduced; and
  - (b) the bonus interests referred to in subsection (1) do not give rise to a \*taxing event generating a gain for you under the table in section 725-335 on any of those original interests.
- (5) To the extent that the \*direct value shift is *from* the original interests to bonus interests to which subsection 6BA(3) of the *Income Tax Assessment Act 1936* applies, the respective \*adjustable values of those bonus interests of which you are an affected owner, in their character as \*trading stock or \*revenue assets, are not uplifted.

**725-230 Off-market buy-backs**

- (1) The consequences are different if:
  - (a) a decrease in the \*market value of a \*down interest of which you are an \*affected owner is reasonably attributable to the

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



target entity proposing to buy back that interest for less than its market value; and

- (b) the target entity does buy back that down interest; and
- (c) subsection 159GZZZQ(2) of the *Income Tax Assessment Act 1936* treats you as having received the down interest's market value worked out as if the buy-back had not occurred and was never proposed to occur.

- (2) The \*adjustable value of the \*down interest is not reduced, and there is no \*taxing event generating a gain.

Note: The down interest is not dealt with here because it is already dealt with in Division 16K of Part III of the *Income Tax Assessment Act 1936*.

- (3) Also, to the extent that the \*direct value shift is from the \*down interest to \*up interests of which you are an \*affected owner, uplifts in the \*adjustable value of the up interests are worked out under either or both of:
  - (a) item 8 of the table in subsection 725-250(2); and
  - (b) item 9 of the table in subsection 725-335(3);as if the down interest were one owned by another affected owner.

### **Subdivision 725-D—Consequences for down interest or up interest as CGT asset**

#### **Table of sections**

725-240	CGT consequences; meaning of <i>adjustable value</i>
725-245	Table of <i>taxing events generating a gain</i> for interests as CGT assets
725-250	Table of consequences for adjustable values of interests as CGT assets
725-255	Multiple CGT consequences for the same down interest or up interest

#### **725-240 CGT consequences; meaning of *adjustable value***

- (1) The CGT consequences for you of a \*direct value shift are of one or more of these 3 kinds:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-240

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- (a) there are one or more \*taxing events generating a gain for \*down interests of which you are an affected owner (see subsection (2));
- (b) the \*cost base and \*reduced cost base of down interests of which you are an \*affected owner are reduced (see subsection (3));
- (c) the cost base and reduced cost base of \*up interests of which you are an affected owner are uplifted (see subsection (4)).

Note: If there is a taxing event generating a gain, CGT event K8 happens. See section 104-250.

*Taxing event generating a gain*

- (2) To work out:
  - (a) whether under the table in section 725-245 there is a \*taxing event generating a gain for you on a \*down interest; and
  - (b) if so, the amount of the gain;assume that the **adjustable value** from time to time of that or any other \*equity or loan interest in the \*target entity is its \*cost base.

Note: For example, for that purpose the question whether the interest has a pre-shift gain or a pre-shift loss is determined on the basis that the interest's adjustable value is its cost base.

*Reduction or uplift of cost base and reduced cost base*

- (3) The \*cost base and the \*reduced cost base of a \*down interest are reduced at the \*decrease time to the extent that section 725-250 provides for the \*adjustable value of the interest to be reduced.
- (4) The \*cost base and the \*reduced cost base of an \*up interest are uplifted at the \*increase time to the extent that section 725-250 provides for the \*adjustable value of the interest to be uplifted.
- (5) However, the \*cost base or \*reduced cost base is *uplifted* only to the extent that the amount of the uplift is still reflected in the \*market value of the interest when a later \*CGT event happens to the interest.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (6) To work out:
- (a) whether the \*cost base or \*reduced cost base of the interest is reduced or uplifted; and
  - (b) if so, by how much;
- assume that:
- (c) the **adjustable value** from time to time of that or any other \*equity or loan interest in the \*target entity is its cost base or reduced cost base, as appropriate; and
  - (d) if the interest is an \*up interest because it was issued at a \*discount—the **adjustable value** of the interest immediately before it was issued was its cost base or reduced cost base, as appropriate, when it was issued.

Note: For example, for that purpose the question whether the interest has a pre-shift gain or a pre-shift loss is determined on the basis that the interest's adjustable value is its cost base or reduced cost base, as appropriate.

*Reductions and uplifts also apply to pre-CGT assets*

- (7) A reduction or uplift occurs regardless of whether the entity that owns the interest \*acquired it before, on or after 20 September 1985.

### **725-245 Table of *taxing events generating a gain* for interests as CGT assets**

To the extent that the \*direct value shift is from \*down interests of which you are an \*affected owner, and that are specified in an item in the table, to \*up interests specified in that item, those up interests give rise to a **taxing event generating a gain** for you on each of those down interests. The gain is worked out under section 725-365.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 725-250

<b><i>Taxing events generating a gain for down interests as CGT assets</i></b>		
<b>Item</b>	<b>Down interests:</b>	<b>Up interests:</b>
1	*down interests that: (a) are owned by <i>you</i> ; and (b) are <i>neither your *revenue assets nor your *trading stock</i> ; and (c) have <i>*pre-shift gains</i> ; and (d) are <i>*post-CGT assets</i>	*up interests owned by <i>you</i> that: (a) are <i>neither your revenue assets nor your trading stock</i> ; and (b) are <i>*pre-CGT assets</i>
2	*down interests that: (a) are owned by <i>you</i> ; and (b) are <i>neither your *revenue assets nor your *trading stock</i> ; and (c) have <i>*pre-shift gains</i>	*up interests owned by <i>you</i> that are <i>your trading stock or revenue assets</i>
3	*down interests owned by <i>you</i> that: (a) are of the one kind (either <i>your *trading stock or your *revenue assets</i> ); and (b) have <i>*pre-shift gains</i>	*up interests owned by <i>you</i> that: (a) are <i>of the other kind</i> (either <i>your revenue assets or your trading stock</i> ); or (b) are <i>neither your *revenue assets nor your *trading stock</i>
4	*down interests owned by <i>you</i> that have <i>*pre-shift gains</i>	up interests owned by <i>other *affected owners</i>

Note: If there is a taxing event generating a gain on a down interest, CGT event K8 happens: see section 104-250. However, a capital gain you make under CGT event K8 is disregarded if the down interest:

- is your trading stock (see section 118-25); or
- is a pre-CGT asset (see subsection 104-250(5)).

### **725-250 Table of consequences for adjustable values of interests as CGT assets**

- (1) The table in subsection (2) sets out consequences of the \*direct value shift for the \*adjustable values of \*down interests and \*up

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-250

interests of which you are an \*affected owner, in their character as \*CGT assets.

- (2) To the extent that the \*direct value shift is from \*down interests specified in an item in the table to \*up interests specified in that item:
- (a) the \*adjustable value of each of those down interests is decreased by the amount worked out under the section (if any) specified for the down interests in the last column of that item; and
  - (b) the adjustable value of each of those \*up interests is uplifted by the amount worked out under the section (if any) specified for the up interests in that column.

<b>Consequences of the direct value shift for adjustable values of CGT assets</b>			
<b>Item</b>	<b>To the extent that the direct value shift is from:</b>	<b>To:</b>	<b>The decrease or uplift is worked out under:</b>
1	*down interests that: (a) are owned by <i>you</i> ; and (b) have * <i>pre-shift gains</i> ; and (c) are * <i>post-CGT assets</i>	*up interests owned by <i>you</i> that do <i>not</i> give rise to a *taxing event generating a gain for you on those down interests under section 725-245	for the down interests: section 725-365; and for the up interests: section 725-370
2	*down interests that: (a) are owned by <i>you</i> ; and (b) have * <i>pre-shift gains</i> ; and (c) are * <i>pre-CGT assets</i>	*up interests owned by <i>you</i> that are * <i>pre-CGT assets</i>	for the down interests: section 725-365; and for the up interests: section 725-370

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Chapter 3** Specialist liability rules**Part 3-95** Value shifting**Division 725** Direct value shifting affecting interests in companies and trusts

## Section 725-250

<b>Consequences of the direct value shift for adjustable values of CGT assets</b>			
<b>Item</b>	<b>To the extent that the direct value shift is from:</b>	<b>To:</b>	<b>The decrease or uplift is worked out under:</b>
3	*down interests that: (a) are owned by <i>you</i> ; and (b) have * <i>pre-shift gains</i> ; and (c) are * <i>pre-CGT assets</i>	*up interests owned by <i>you</i> that are * <i>post-CGT assets</i>	for the down interests: section 725-365; and for the up interests: section 725-375
4	*down interests owned by <i>you</i> that have * <i>pre-shift gains</i>	*up interests owned by <i>you</i> that give rise to a *taxing event generating a gain on those down interests under section 725-245	for the down interests: section 725-365; and for the up interests: section 725-375
5	*down interests owned by <i>you</i> that have * <i>pre-shift losses</i>	*up interests owned by <i>you</i>	for the down interests: section 725-380; and for the up interests: section 725-375
6	*down interests owned by <i>you</i> that have * <i>pre-shift gains</i>	*up interests owned by <i>other</i> * <i>affected owners</i>	for the down interests: section 725-365
7	*down interests owned by <i>you</i> that have * <i>pre-shift losses</i>	*up interests owned by <i>other</i> * <i>affected owners</i>	for the down interests: section 725-380
8	*down interests owned by <i>other</i> * <i>affected owners</i>	*up interests owned by <i>you</i>	for the up interests: section 725-375
9	*down interests owned by <i>you</i>	*up interests owned by <i>entities that are not</i> * <i>affected owners</i>	(there are no decreases or uplifts)

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-255

<b>Consequences of the direct value shift for adjustable values of CGT assets</b>			
<b>Item</b>	<b>To the extent that the direct value shift is from:</b>	<b>To:</b>	<b>The decrease or uplift is worked out under:</b>
10	*down interests owned by <i>entities that are not affected owners</i>	*up interests owned by <i>you</i>	(there are no decreases or uplifts)

*Reducing uplift to prevent double increase in cost base etc.*

- (3) However, if, apart from paragraph (2)(b), an amount is included in the \*cost base or \*reduced cost base of an \*up interest as a result of the \*scheme under which the \*direct value shift happens, the uplift in the \*adjustable value of the interest under that paragraph is reduced by that amount.

### **725-255 Multiple CGT consequences for the same down interest or up interest**

- (1) A \*down interest or \*up interest of which you are an \*affected owner may be covered by 2 or more items in the table in subsection 725-250(2).
- (2) If the \*cost base or \*reduced cost base of the same \*down interest or \*up interest is decreased or uplifted under 2 or more items, it is decreased or uplifted by the total of the amounts worked out under those items.
- Note: If subsection 725-250(3) is relevant, it will affect all the uplifts worked out under all those items.
- (3) If for a particular \*down interest there is a \*taxing event generating a gain under an item in the table in section 725-245, that taxing event is in addition to:
- (a) each taxing event generating a gain for that interest under any other item in that table; and
  - (b) each decrease in the \*cost base or \*reduced cost base of the interest under an item in the table in subsection 725-250(2).

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-310

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**Subdivision 725-E—Consequences for down interest or up interest as trading stock or a revenue asset**

**Table of sections**

725-310	Consequences for down interest or up interest as trading stock
725-315	<i>Adjustable value</i> of trading stock
725-320	Consequences for down interest or up interest as a revenue asset
725-325	<i>Adjustable value</i> of revenue asset
725-335	How to work out those consequences
725-340	Multiple trading stock or revenue asset consequences for the same down interest or up interest

**725-310 Consequences for down interest or up interest as trading stock**

- (1) The consequences of the \*direct value shift for your \*trading stock are of one or more of these 3 kinds:
  - (a) the \*adjustable values of \*down interests of which you are an \*affected owner are reduced (see subsection (2));
  - (b) the adjustable values of \*up interests of which you are an affected owner are uplifted (see subsection (3));
  - (c) there are one or more \*taxing events generating a gain for down interests of which you are an affected owner (see subsection (5)).

*Effect of reduction or uplift of adjustable value*

- (2) If the \*adjustable value of a \*down interest that is your \*trading stock is reduced under section 725-335, you are treated as if:
  - (a) \*immediately before the \*decrease time, you had sold the interest to someone else (at \*arm's length and in the ordinary course of business) for its \*adjustable value immediately before the decrease time; and
  - (b) immediately after the decrease time, you had bought the interest back for the reduced adjustable value.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 725-315

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- (3) If the \*adjustable value of an \*up interest that is your \*trading stock is uplifted under section 725-335, you are treated as if:
- (a) \*immediately before the \*increase time, you had sold the interest to someone else (at \*arm's length and in the ordinary course of business) for its \*adjustable value immediately before the increase time; and
  - (b) immediately after the increase time, you had bought the interest back for the uplifted adjustable value.
- (4) However, the increase in the cost of an \*up interest because of paragraph (3)(b) is taken into account from time to time only to the extent that the amount of the increase is still reflected in the \*market value of the interest.

Note: The situations where the increase in cost would be taken into account include:

- in working out your deductions for the cost of trading stock acquired during the income year in which the increase time happens; and
- the end of an income year if the interest's closing value as trading stock is worked out on the basis of its cost; and
- the start of the income year in which the interest is disposed of, if that happens in a later income year and the interest's closing value as trading stock at the end of the previous income year was worked out on the basis of its cost.

If the interest stops being trading stock, section 70-110 treats you as having disposed of it.

*Taxing event generating a gain*

- (5) For each \*taxing event generating a gain under an item in the table in subsection 725-335(3), the gain is included in your assessable income for the income year in which the \*decrease time happens.

### **725-315 Adjustable value of trading stock**

If a \*down interest or \*up interest is your \*trading stock, its ***adjustable value*** at a particular time is:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) if the interest has been trading stock of yours ever since the start of the income year in which that time occurs—its \*value as trading stock at the start of the income year; or
- (b) otherwise—its cost.

Note 1: If an interest has been affected by an earlier direct value shift during the same income year, it will be treated as having already been sold and repurchased (because of an earlier application of section 725-310). As a result, the cost on repurchase becomes its adjustable value immediately before the decrease time or increase time for the later direct value shift.

Note 2: The adjustable value of an interest that is an up interest because it was issued at a discount is worked out under paragraph (b).

**725-320 Consequences for down interest or up interest as a revenue asset**

- (1) The consequences of the \*direct value shift for your \*revenue assets are of one or more of these 3 kinds:
  - (a) the \*adjustable values of \*down interests of which you are an \*affected owner are reduced (see subsection (2));
  - (b) the adjustable values of \*up interests of which you are an affected owner are uplifted (see subsection (3));
  - (c) one or more \*taxing events generating a gain for down interests of which you are an affected owner (see subsection (5)).

*Effect of reduction or uplift of adjustable value*

- (2) If the \*adjustable value of a \*down interest that is your \*revenue asset is decreased under section 725-335, you are treated as if:
  - (a) \*immediately before the \*decrease time, you had sold the interest to someone else for its \*adjustable value immediately before the decrease time; and
  - (b) immediately afterwards, you had bought the interest back for the reduced adjustable value; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-325

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- (c) from the time when you bought it back, the interest continued to be a revenue asset, for the same reasons as it was a revenue asset before you sold it.
- (3) If the \*adjustable value of an \*up interest that is your \*revenue asset is uplifted under section 725-335, you are treated as if:
  - (a) \*immediately before the \*increase time, you had sold the interest to someone else for its \*adjustable value immediately before the increase time; and
  - (b) immediately afterwards, you had bought the interest back for the uplifted adjustable value; and
  - (c) from the time when you bought it back, the interest continued to be a revenue asset, for the same reasons as it was a revenue asset before you sold it.
- (4) However, the uplift in \*adjustable value is taken into account only to the extent that the amount of the uplift is still reflected in the \*market value of the interest when it is disposed of or otherwise realised.

*Taxing event generating a gain*

- (5) For each \*taxing event generating a gain under an item in the table in subsection 725-335(3), the gain is included in your assessable income for the income year in which the \*decrease time happens.

**725-325 Adjustable value of revenue asset**

- (1) If a \*down interest is your \*revenue asset, its **adjustable value** immediately before the \*decrease time is the total of the amounts that would be subtracted from the gross disposal proceeds in calculating any profit or loss on disposal of the interest if you disposed of it immediately before the decrease time.
- (2) If an \*up interest is your \*revenue asset and it increases in \*market value because of the \*direct value shift, its **adjustable value** immediately before the \*increase time is the total of the amounts that would be subtracted from the gross disposal proceeds in

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-335

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calculating any profit or loss on disposal of the interest if you disposed of it immediately before the increase time.

- (3) If an \*up interest is your \*revenue asset and it is issued at a \*discount, it is taken to have an **adjustable value** immediately before it is issued equal to the consideration paid or given by you for the interest.

Note: If an interest has been affected by an earlier direct value shift during the same income year, it will be treated as having already been sold and repurchased (because of an earlier application of section 725-320). As a result, the cost on repurchase becomes its adjustable value immediately before the decrease time or increase time for the later direct value shift.

**725-335 How to work out those consequences**

- (1) This section sets out the consequences of the \*direct value shift for a \*down interest or \*up interest as \*trading stock or a \*revenue asset.
- (2) If you have both \*trading stock and \*revenue assets, items 1 and 2 of the table in subsection (3) can apply once to the trading stock and again to the revenue assets. The other items apply (if at all) to the trading stock and revenue assets together.

*Decreases and uplifts in adjustable value*

- (3) To the extent that the \*direct value shift is from \*down interests specified in an item in the table to \*up interests specified in that item:
- (a) the \*adjustable value of each of those down interests is decreased by the amount worked out under the section (if any) specified for the down interests in the last column of that item; and
  - (b) the adjustable value of each of those \*up interests is uplifted by the amount worked out under the section (if any) specified for the up interests in that column.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 725-335

<b>Consequences for down interest or up interest as trading stock or revenue asset</b>			
<b>Item</b>	<b>To the extent that the direct value shift is from:</b>	<b>To:</b>	<b>The decrease or uplift is worked out under:</b>
1	*down interests owned by <i>you</i> that: (a) are of the one kind (either <i>your</i> *trading stock or <i>your</i> *revenue assets); and (b) have *pre-shift gains	*up interests owned by <i>you</i> that are <i>of that same kind</i>	for the down interests: section 725-365; and for the up interests: section 725-370
2	*down interests owned by <i>you</i> that: (a) are of the one kind (either <i>your</i> *trading stock or <i>your</i> *revenue assets); and (b) have *pre-shift gains	*up interests owned by <i>you</i> that are <i>of the other kind</i> (either <i>your</i> revenue assets or <i>your</i> trading stock)	for the down interests: section 725-365; and for the up interests: section 725-375
3	*down interests owned by <i>you</i> that: (a) are <i>your</i> *trading stock or *revenue assets; and (b) have *pre-shift losses	*up interests owned by <i>you</i> that are <i>of that same kind or of the other kind</i>	for the down interests: section 725-380; and for the up interests: section 725-375
4	*down interests owned by <i>you</i> that: (a) are <i>your</i> *trading stock or *revenue assets; and (b) have *pre-shift gains	*up interests owned by <i>you</i> that are <i>neither your revenue assets nor your trading stock</i>	for the down interests: section 725-365
5	*down interests owned by <i>you</i> that: (a) are <i>your</i> *trading stock or *revenue assets; and (b) have *pre-shift losses	*up interests owned by <i>you</i> that are <i>neither your revenue assets nor your trading stock</i>	for the down interests: section 725-380

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 725-335

<b>Consequences for down interest or up interest as trading stock or revenue asset</b>			
<b>Item</b>	<b>To the extent that the direct value shift is from:</b>	<b>To:</b>	<b>The decrease or uplift is worked out under:</b>
6	*down interests owned by <i>you</i> that are <i>neither your *revenue assets nor your *trading stock</i>	*up interests owned by <i>you</i> that are <i>your trading stock or revenue assets</i>	for the up interests: section 725-375
7	*down interests owned by <i>you</i> that: (a) are <i>your *trading stock</i> or <i>*revenue assets</i> ; and (b) have <i>*pre-shift gains</i>	up interests owned by <i>other *affected owners</i>	for the down interests: section 725-365
8	*down interests owned by <i>you</i> that: (a) are <i>your *trading stock</i> or <i>*revenue assets</i> ; and (b) have <i>*pre-shift losses</i>	*up interests owned by <i>other *affected owners</i>	for the down interests: section 725-380
9	*down interests owned by <i>other *affected owners</i>	*up interests owned by <i>you</i> that are <i>your *trading stock or *revenue assets</i>	for the up interests: section 725-375
10	*down interests owned by <i>you</i> that are <i>your *trading stock or *revenue assets</i>	*up interests owned by <i>entities that are not *affected owners</i>	(there are no decreases or uplifts)
11	*down interests owned by <i>entities that are not *affected owners</i>	*up interests owned by <i>you</i> that are <i>your *trading stock or *revenue assets</i>	(there are no decreases or uplifts)

*Reducing uplift to prevent double increase in adjustable value*

- (3A) However, if, apart from paragraph (3)(b), an amount is included, as a result of the \*scheme under which the \*direct value shift happens, in the \*adjustable value of an \*up interest that is your \*trading stock

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

or \*revenue asset, the uplift in the adjustable value of the interest under that paragraph is reduced by that amount.

*Taxing events generating a gain*

- (4) To the extent that the \*direct value shift is from \*down interests:
- (a) of which you are an \*affected owner; and
  - (b) that are specified in item 2, 4 or 7 in the table in subsection (3);
- to \*up interests specified in that item, those up interests give rise to a **taxing event generating a gain** for you under that item on each of those down interests. The gain is worked out under section 725-365.

**725-340 Multiple trading stock or revenue asset consequences for the same down interest or up interest**

- (1) A \*down interest or \*up interest of which you are an \*affected owner may be covered by 2 or more items in the table in subsection 725-335(3).
- (2) If the \*adjustable value of the same \*down interest or \*up interest is decreased or uplifted under 2 or more items, it is decreased or uplifted by the total of the amounts worked out under those items.
- Note: If subsection 725-335(3A) is relevant, it will affect all the uplifts worked out under all those items.
- (3) If for a particular \*down interest there is a \*taxing event generating a gain under an item, that taxing event is in addition to:
- (a) each taxing event generating a gain for that interest under any other item in the table; and
  - (b) each decrease in the \*adjustable value of the interest under that or any other item in the table.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 725-365

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**Subdivision 725-F—Value adjustments and taxed gains**

**Table of sections**

725-365	Decreases in adjustable values of down interests (with pre-shift gains), and taxing events generating a gain
725-370	Uplifts in adjustable values of up interests under certain table items
725-375	Uplifts in adjustable values of up interests under other table items
725-380	Decreases in adjustable value of down interests (with pre-shift losses)

**725-365 Decreases in adjustable values of down interests (with pre-shift gains), and taxing events generating a gain**

Use the following method statement:

- (a) to work out the amount of the gain for a \*taxing event generating a gain under:
  - (i) section 725-245; or
  - (ii) item 2, 4 or 7 of the table in subsection 725-335(3); and
- (b) to work out the decrease in \*adjustable value of a \*down interest under:
  - (i) item 1, 2, 3, 4 or 6 of the table in subsection 725-250(2); or
  - (ii) item 1, 2, 4 or 7 of the table in subsection 725-335(3).

*Method statement*

Step 1. Group together all \*down interests that:

- (a) are of the kind referred to in the relevant item; and
- (b) immediately before the \*decrease time, had the same \*adjustable value as the down interest; and
- (c) immediately before that time had the same \*market value as the down interest; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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(d) sustained the same decrease in market value as the down interest because of the \*direct value shift.

Step 2. Work out the value shifted from that group of \*down interests to the \*up interests referred to in the relevant item using the following formula:

$$\frac{\text{Sum of the decreases in *market value of all *down interests in the group because of the *direct value shift}}{\text{Sum of the increases in *market value of, and *discounts on the issue of, those *up interests because of the *direct value shift}} \times \frac{\text{Sum of the increases in *market value of, and *discounts given on the issue of, all *up interests because of the *direct value shift}}{\text{Sum of the increases in *market value of, and *discounts given on the issue of, all *up interests because of the *direct value shift}}$$

Step 3. Work out the notional adjustable value of the value shifted from that group of \*down interests to those \*up interests using the formula:

$$\frac{\text{Sum of the *adjustable values, immediately before the *decrease time, of all *down interests in the group}}{\text{Sum of the *market values, immediately before the *decrease time, of all *down interests in the group}} \times \frac{\text{Value shifted}}{\text{Sum of the *market values, immediately before the *decrease time, of all *down interests in the group}}$$

Step 4. The decrease in the \*adjustable value of the \*down interest under the relevant item is equal to:

$$\frac{\text{Notional adjustable value}}{\text{Number of *down interests in the group}}$$

Step 5. For a \*taxing event generating a gain under the relevant item, the amount of the gain is equal to:

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-370

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$$\frac{\text{Value shifted} - \text{Notional adjustable value}}{\text{Number of *down interests in the group}}$$

**725-370 Uplifts in adjustable values of up interests under certain table items**

Use the following method statement to work out the uplift in \*adjustable value of an \*up interest under:

- (a) item 1 or 2 of the table in subsection 725-250(2); or
- (b) item 1 of the table in subsection 725-335(3).

*Method statement*

Step 1. If the \*market value of the \*up interest increases because of the \*direct value shift, group together all up interests of the kind referred to in the relevant item that:

- (a) immediately before the \*increase time, had the same \*adjustable value as the up interest; and
- (b) sustained the same increase in market value as the up interest because of the \*direct value shift.

If the \*up interest is issued at a \*discount, group together all \*up interests of the kind referred to in the relevant item that:

- (c) immediately before the \*increase time, had the same \*adjustable value as the up interest; and
- (d) because of the direct value shift, are issued at the same discount as the up interest.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 725-375

Step 2. The notional adjustable value of the value shifted from the \*down interests referred to in the relevant item to all the \*up interests referred to in that item has already been worked out under one or more applications of step 3 of the method statement in section 725-365.

Step 3. Use the following formula to work out how much of that notional adjustable value is attributable to the value shifted to the group of \*up interests referred to in step 1 of this method statement:

$$\text{Notional adjustable value} \times \frac{\text{Sum of the *market values, immediately after the *increase time, of all *up interests in the group}}{\text{Sum of the *market values, immediately after the *increase time, of all *up interests referred to in the relevant item}}$$

Step 4. The uplift in the \*adjustable value of the \*up interest under the relevant item is equal to:

$$\frac{\text{The amount worked out under step 3}}{\text{Number of interests in that group of *up interests}}$$

### 725-375 Uplifts in adjustable values of up interests under other table items

Use the following method statement to work out the uplift in \*adjustable value of an \*up interest under:

- (a) item 3, 4, 5 or 8 of the table in subsection 725-250(2); or
- (b) item 2, 3, 6 or 9 of the table in subsection 725-335(3).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-375

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*Method statement*

Step 1. If the \*market value of the \*up interest increases because of the direct value shift, group together all \*up interests of the kind referred to in the relevant item that sustained the same increase in market value as the up interest because of the direct value shift.

If the up interest is issued at a discount, group together all up interests of the kind referred to in the relevant item that are issued at a discount of the same amount as the up interest because of the direct value shift.

Step 2. The value shifted to that group of \*up interests from the \*down interests referred to in the relevant item is the amount worked out using the formula:

$$\frac{\text{Sum of the group increases or discounts} \times \text{Sum of the decreases in *market value of those *down interests}}{\text{Total value of the *direct value shift}}$$

where:

***sum of the group increases or discounts*** means (as appropriate):

- (a) the sum of the increases in \*market value of all \*up interests in the group because of the \*direct value shift; or
- (b) the sum of the \*discounts at which all \*up interests in the group were issued because of the \*direct value shift.

***total value of the direct value shift*** means:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) if the sum of the decreases in \*market value of all \*down interests because of the \*direct value shift is equal to or greater than the sum of the increases in market value of all \*up interests and all \*discounts given because of the shift—the sum of the decreases; or
- (b) if the sum of the decreases in market value of all down interests because of the direct value shift is less than the sum of the increases in market value of all up interests and all discounts given because of the shift—the sum of the increases and discounts.

Step 3. The uplift in the \*adjustable value of the \*up interest under the relevant item is equal to:

$$\frac{\text{Value shifted}}{\text{Number of *up interests in the group}}$$

### **725-380 Decreases in adjustable value of down interests (with pre-shift losses)**

Use the following method statement to work out the decrease in \*adjustable value of a \*down interest under:

- (a) item 5 or 7 of the table in subsection 725-250(2); or
- (b) item 3, 5 or 8 of the table in subsection 725-335(3).

#### *Method statement*

Step 1. Group together all \*down interests of the kind referred to in the relevant item that:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 725-380

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- (a) immediately before the \*decrease time, had the same \*adjustable value as the down interest; and
- (b) immediately before that time had the same \*market value as the down interest; and
- (c) sustained the same decrease in market value as the down interest because of the \*direct value shift.

Step 2. Work out the value shifted from that group of \*down interests to the \*up interests referred to in the relevant item using the formula:

$$\frac{\text{Sum of the decreases in *market value of all *down interests in the group because of the *direct value shift}}{\text{Sum of the increases in *market value of, and *discounts on the issue of, those *up interests because of the *direct value shift}} \times \frac{\text{Sum of the increases in *market value of, and *discounts given on the issue of, all *up interests because of the *direct value shift}}{\text{Sum of the increases in *market value of, and *discounts on the issue of, those *up interests because of the *direct value shift}}$$

Step 3. The decrease in \*adjustable value of the \*down interest under the relevant item is equal to:

$$\frac{\text{Value shifted}}{\text{Number of *down interests in the group}}$$

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Division 727—Indirect value shifting affecting interests in companies and trusts, and arising from non-arm's length dealings**

### **Table of Subdivisions**

#### Guide to Division 727

727-A	Scope of the indirect value shifting rules
727-B	What is an indirect value shift
727-C	Exclusions
727-D	Working out the market value of economic benefits
727-E	Key concepts
727-F	Consequences of an indirect value shift
727-G	The realisation time method
727-H	The adjustable value method
727-K	Reduction of loss on equity or loan interests realised before the IVS time
727-L	Indirect value shift resulting from a direct value shift

### **Guide to Division 727**

#### **727-1 What this Division is about**

If there is a net shift of value between 2 related entities because of a non-arm's length dealing, this Division:

- (a) prevents losses from arising, because of the value shift, on realisation of direct or indirect equity or loan interests in the losing entity; and

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 727-5**

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- (b) within limits, prevents gains from arising, because of the value shift, on realisation of direct or indirect equity or loan interests in the gaining entity.

However, it does so only for interests that are owned by entities involved in the value shift.

**Table of sections**

727-5	What is an indirect value shift?
727-10	How does this Division deal with indirect value shifts?
727-15	When does an indirect value shift have consequences under this Division?
727-25	Effect of this Division on realisations at a loss that occur before the nature or extent of an indirect value shift can be fully determined

**727-5 What is an indirect value shift?**

- (1) An indirect value shift arises when there is a net shift of value from one entity to another.

Example: Company A transfers property to company B in return for a cash payment. If the market value of the property is \$180 million but the cash payment is only \$50 million, there is a net shift of value from company A to company B of \$130 million.

- (2) It is called *indirect* because the transaction will have the indirect effect of shifting value from equity or loan interests in the losing entity to equity or loan interests in the gaining entity.

This is because the net shift in value between the entities will usually *decrease* the market value of interests in the losing entity and *increase* the market value of interests in the gaining entity.

Example: Assume that company C owns all the shares in company A and company D owns all the shares in company B. The net shift of value from company A to company B will reduce the value of company C's shares in company A and increase the value of company D's shares in company B.

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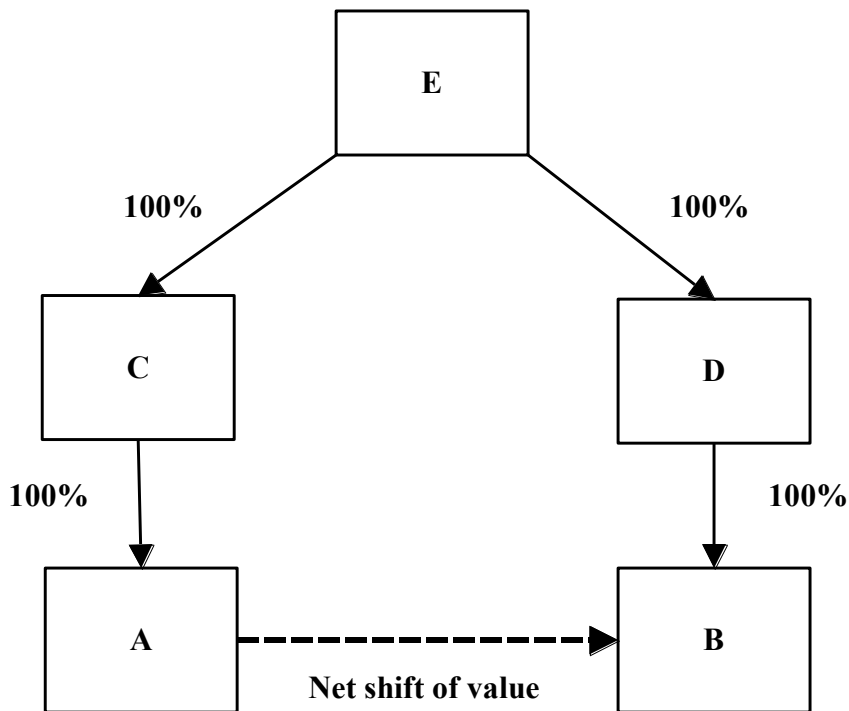
\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (3) It will also produce corresponding effects further up a chain of entities.

Example: Assume that company E owns all the shares in company C and company D. The net shift of value from company A to company B will also reduce the value of company E's shares in company C and increase the value of its shares in company D.



- (4) This Division is *not* concerned with the tax treatment of the net shift in value between the entities at the bottom of the chains. Instead, it deals with the effects on the market value of interests (both direct and indirect) in those entities.
- (5) An indirect value shift distorts the relationship between the market value of an equity or loan interest and its value for income tax purposes. When the interest is realised, this can produce an

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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inappropriate loss for income tax purposes, or an inappropriate gain.

Example: If company E sold its shares in company C, the indirect value shift could (apart from this Division) result in a loss for income tax purposes. Company E could defer the corresponding gain on its shares in company D by not selling these.

**727-10 How does this Division deal with indirect value shifts?**

- (1) To prevent an inappropriate loss or gain from arising on realisation of an interest, this Division reduces the amount of the loss or gain (realisation time method). However, a choice can be made to adjust the interest's value for income tax purposes in a way that takes account of the indirect value shift (adjustable value method).
- (2) This Division does *not* create taxing events giving rise to gains or losses.

**727-15 When does an indirect value shift have consequences under this Division?**

- (1) Indirect value shift is defined very broadly, but the application of this Division is limited in various ways.
- (2) The losing entity must be a company or trust (except a superannuation entity). However, the gaining entity can be any kind of entity, including an individual.
- (3) This Division does *not* apply if entities deal with each other at arm's length, or provide economic benefits in return for full market value.
- (4) The losing entity and the gaining entity must be connected by having had the same *ultimate controller*. In the case of closely held entities, they may instead be connected by having had a high level of *common ownership*.
- (5) The only interests affected are those owned by entities involved in the indirect value shift or by their associates.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-25

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- (6) There are a range of exclusions, such as:
  - (a) exclusions for minor indirect value shifts; and
  - (b) a series of rules designed to provide safe harbour treatment for common transactions relating to services; and
  - (c) anti-overlap provisions to prevent double-counting.
- (7) Rules of thumb are included to make it easier to determine the market value of some kinds of economic benefits.
- (8) To reduce compliance costs for:
  - (a) \*small business entities; and
  - (b) entities that meet the CGT small business net asset threshold (\$6 million);interests owned by those entities are not affected by this Division.

**727-25 Effect of this Division on realisations at a loss that occur before the nature or extent of an indirect value shift can be fully determined**

- (1) To determine whether a scheme gives rise to an indirect value shift, it must be possible to identify all the economic benefits under the scheme, and the providers and recipients of those benefits.
- (2) Before then, interests that might be affected by the scheme may be realised at a loss. Subdivision 727-K contains special rules that apply if that happens.

**Subdivision 727-A—Scope of the indirect value shifting rules**

**Table of sections**

727-95	Main object
727-100	When an indirect value shift has consequences under this Division
727-105	Ultimate controller test
727-110	Common-ownership nexus test (if both losing and gaining entities are closely held)
727-125	No consequences if losing entity is a complying superannuation entity etc.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-95

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**727-95 Main object**

The main object of this Division is:

- (a) to prevent inappropriate losses from arising on the realisation of direct or indirect equity or loan interests in an entity from which there has been a net shift of value because of a dealing that is not at \*arm's length; and
- (b) to prevent inappropriate gains from arising on the realisation of \*direct equity interests or \*indirect equity interests in the entity to which that value has been shifted;

in cases where the 2 entities are related as set out in this Division.

**727-100 When an indirect value shift has consequences under this Division**

An \*indirect value shift (see Subdivision 727-B) has consequences under this Division if, and only if:

- (a) the \*losing entity is at the time of the indirect value shift a company or trust (except one listed in section 727-125 (about superannuation entities)); and
- (b) in relation to either or both of the following:
  - (i) the losing entity \*providing one or more economic benefits to the gaining entity \*in connection with the \*scheme from which the indirect value shift results;
  - (ii) the gaining entity providing one or more economic benefits to the losing entity in connection with the scheme;

the 2 entities are not dealing with each other at \*arm's length; and

- (c) either or both of sections 727-105 and 727-110 are satisfied; and
- (d) no exclusion in Subdivision 727-C applies.

Note 1: The consequences for direct and indirect interests in the losing entity or in the gaining entity are set out in Subdivision 727-F. If those consequences are to be worked out using the realisation time method

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 727-105**

(under Subdivision 727-G), there are further exclusions for certain 95% services indirect value shifts: see section 727-700.

Note 2: An indirect value shift does not have consequences for interests in the losing entity or gaining entity owned immediately before the IVS time by an entity that:

- is a small business entity for each income year that includes any of the IVS period; or
- would satisfy the maximum net asset value test in section 152-15 throughout the IVS period.

See subsection 727-470(2).

**727-105 Ultimate controller test**

It must be the case that, at some time during the \*IVS period:

- (a) the \*losing entity and the \*gaining entity have the same \*ultimate controller; or
- (b) the ultimate controller of the losing entity is the same entity that was the ultimate controller of the gaining entity at a different time during that period; or
- (c) the gaining entity is the ultimate controller of the losing entity; or
- (d) the losing entity is the ultimate controller of the gaining entity.

For the concept of *IVS period*, see section 727-150.

For the concept of *ultimate controller*, see section 727-350.

**727-110 Common-ownership nexus test (if both losing and gaining entities are closely held)**

(1) Or, it must be the case that:

- (a) at some time during the \*IVS period, neither the \*losing entity nor the \*gaining entity has 300 or more members (in the case of a company) or 300 or more beneficiaries (in the case of a trust); and
- (b) the losing entity and the gaining entity have a \*common-ownership nexus within the IVS period.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Chapter 3 Specialist liability rules

### Part 3-95 Value shifting

**Division 727** Indirect value shifting affecting interests in companies and trusts, and arising from non-arm's length dealings

#### Section 727-125

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For the concept of *IVS period*, see section 727-150.

For the concept of *common-ownership nexus*, see section 727-400.

- (2) Section 124-810 (under which certain companies and trusts are not regarded as having 300 or more members or beneficiaries) also applies for the purposes of this Division.
- (3) In addition, this Division applies to a \*non-fixed trust as if it did not have 300 or more beneficiaries.

#### **727-125 No consequences if losing entity is a complying superannuation entity etc.**

An \*indirect value shift has no consequences under this Division if the \*losing entity is one of the following in relation to the income year in which the indirect value shift happens:

- (a) a \*complying superannuation entity;
- (b) a \*non-complying superannuation fund;
- (c) a \*non-complying approved deposit fund.

#### **Subdivision 727-B—What is an indirect value shift**

##### **Table of sections**

727-150	How to determine whether a scheme results in an indirect value shift
727-155	Providing economic benefits
727-160	When an economic benefit is provided <i>in connection with</i> a scheme
727-165	Preventing double-counting of economic benefits

#### **727-150 How to determine whether a scheme results in an indirect value shift**

- (1) A \*scheme can result in one or more \*indirect value shifts only if one or more economic benefits have been, are being, or are to be, \*provided \*in connection with the scheme.
- (2) The question whether the \*scheme has that result must be determined by reference to the facts and circumstances that exist at

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 727-150

the earliest time (either when the scheme is entered into or later) when it is reasonable to conclude that:

- (a) all the economic benefits that have been, are being, or are to be, \*provided \*in connection with the scheme can be identified; and
- (b) for each of those economic benefits:
  - (i) the entity that has provided, is providing, or is to provide, the economic benefit can be identified; and
  - (ii) the entity to which the economic benefit has been, is being, or is to be, provided can be identified; and
  - (iii) if the economic benefit is to be provided—those entities are in existence, and the providing of the economic benefit is not contingent; and
- (c) there are no other economic benefits that are to be provided in connection with the scheme if some contingency is met.

That time is called the **IVS time** for the scheme.

Note: In most cases, the IVS time will be at or soon after the scheme is entered into. However, if:

- direct or indirect interests in a company or trust are realised at a loss when the IVS time for the scheme has not yet happened (even if it never happens); and
- the company or trust has provided, is providing, is to provide, or might provide, economic benefits in connection with the scheme;

there may be consequences for those interests similar to those of an indirect value shift resulting from the scheme. See Subdivision 727-K.

- (3) The \*scheme results in an **indirect value shift** from one entity (the **losing entity**) to another entity (the **gaining entity**) if the total \*market value of the one or more economic benefits (the **greater benefits**) that the losing entity has \*provided, is providing, or is to provide, to the gaining entity \*in connection with the scheme exceeds:
  - (a) the total market value of the one or more economic benefits (**lesser benefits**) that the gaining entity has provided, is providing, or is to provide, to the losing entity in connection with the scheme; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 727-155**

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- (b) if there are no economic benefits covered by paragraph (a)—  
nil.

That excess is the amount of the indirect value shift.

- (4) The \*market value of an economic benefit is to be determined as at the earliest time when it is reasonable to conclude that:
  - (a) the economic benefit can be identified; and
  - (b) paragraph (2)(b) is satisfied for that benefit.

For more rules affecting how the market value of an economic benefit is determined, see Subdivision 727-D.

- (5) Neither the \*losing entity nor the \*gaining entity needs to be a party to the \*scheme. A benefit can be provided by act or omission.
- (6) The indirect value shift happens at the \*IVS time.
- (7) The ***IVS period*** for a \*scheme starts immediately before the scheme is entered into and ends at the \*IVS time.
- (8) A contingency that is artificial, or is virtually certain to be met, is treated under this Division as if it had been met.

**727-155 Providing economic benefits**

*Examples*

- (1) These are some examples of an entity providing an economic benefit to another entity:
  - (a) the first entity pays an amount to the other entity (in this case the \*market value of the benefit is the amount of the payment);
  - (b) the first entity provides an asset or services to the other entity;
  - (c) the first entity does something that creates an asset in the hands of the other entity (for example, a company issues shares to its members);
  - (d) the first entity incurs a liability to the other entity, or increases a liability it already owes to the other entity;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



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Section 727-160

- (e) the first entity terminates all or part of a liability owed by the other entity;
  - (f) the first entity does something that increases the market value of an asset that the other entity holds.
- (2) These examples are not intended to limit the meaning of providing an economic benefit.

*Things treated as economic benefits*

- (3) This Division applies as if the ending of:
- (a) a \*primary equity interest or \*secondary equity interest in an entity; or
  - (b) a right that the owner of a \*primary equity interest or \*secondary equity interest in an entity has because of owning the interest;
- were an economic benefit that the owner of the interest provides to that entity.

**727-160 When an economic benefit is provided *in connection with* a scheme**

- (1) An economic benefit has been, is being, is to be, or might be, \*provided by an entity to another entity ***in connection with*** a \*scheme if, and only if:
- (a) the benefit has been, is being, is to be, or might be, provided under the scheme; or
  - (b) the providing of the benefit is reasonably attributable to:
    - (i) something that has been, is being, is to be, or might be, done or omitted under the scheme (whether before, at the time of, or after, the providing of the benefit) by an entity that is either of those entities or a third entity; or
    - (ii) 2 or more such things.
- (2) An entity referred to in paragraph (1)(b) need not be a party to the \*scheme. A benefit can be provided by act or omission.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-165

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**727-165 Preventing double-counting of economic benefits**

*Rights to have economic benefits provided*

- (1) If an economic benefit that has been, is being, is to be, or might be, \*provided as mentioned in subsection 727-150(3) or 727-855(1) consists of a right to have economic benefits provided, that subsection applies to the right but does not also apply to those economic benefits.

Example: Acme Ltd enters into an agreement with Paragon Pty Ltd under which Acme is to provide services to Paragon over a 5 year period in return for payments.

Paragon's rights under the agreement are economic benefits that Acme provides to Paragon when the agreement is made. The services are economic benefits that Acme is to provide to Paragon.

Because of this subsection, the market value of the rights is taken into account in working out whether there has been an indirect value shift, but the market value of the services is not.

*Effect of an economic benefit on interests in the entity to which it is provided*

- (2) If an economic benefit has been, is being, or is to be, \*provided to an entity, then, for the purposes of subsection 727-150(3) or 727-855(1), disregard an economic benefit to the extent that:
- (a) it consists of an increase in the \*market value of:
    - (i) an \*equity or loan interest in the entity; or
    - (ii) an \*indirect equity or loan interest in the entity; and
  - (b) the increase is reasonably attributable to the first-mentioned benefit.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Subdivision 727-C—Exclusions****Guide to Subdivision 727-C****727-200 What this Subdivision is about**

Some indirect value shifts do not have consequences under this Division.

- Note 1: If the consequences of an indirect value shift are to be worked out using the realisation time method (under Subdivision 727-G), there are further exclusions for certain 95% services indirect value shifts: see section 727-700.
- Note 2: For cases where there may be both a direct value shift and an indirect value shift, see Subdivision 727-L.

**Table of sections****General**

- 727-215 Amount does not exceed \$50,000
- 727-220 Disposal of asset at cost, or at undervalue if full value is not reflected in adjustable values of equity or loan interests in the losing entity

**Indirect value shifts involving services**

- 727-230 Services provided by losing entity to gaining entity for at least their direct cost
- 727-235 Services provided by gaining entity to losing entity for no more than a commercially realistic price
- 727-240 What services certain provisions apply to
- 727-245 How to work out certain amounts for the purposes of sections 727-230 and 727-235

**Anti-overlap provisions**

- 727-250 Distribution by an entity to a member or beneficiary

**Miscellaneous**

- 727-260 Shift down a wholly-owned chain of entities

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 727-215

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**General**

**727-215 Amount does not exceed \$50,000**

- (1) An \*indirect value shift does not have consequences under this Division if the amount of it does not exceed \$50,000.
- (2) However, subsection (1) does not apply to an \*indirect value shift (and is taken never to have applied to it) if:
  - (a) before, at the same time as, or after it, another indirect value shift happens for which the same entity is the losing entity as for the first indirect value shift; and
  - (b) having regard to all relevant circumstances, it is reasonable to conclude that the sole or main reason why one of the indirect value shifts happened under a different \*scheme from the other was so that its amount would not exceed \$50,000.

**727-220 Disposal of asset at cost, or at undervalue if full value is not reflected in adjustable values of equity or loan interests in the losing entity**

- (1) An \*indirect value shift does not have consequences under this Division if the conditions in this section are met.
- (2) The \*greater benefits must consist entirely of:
  - (a) the \*losing entity transferring a \*CGT asset to the \*gaining entity; or
  - (b) a right to have the losing entity transfer an asset to the gaining entity.
- (3) There must be \*lesser benefits and, as at the \*IVS time, the total \*market value of the lesser benefits must not be less than the greatest of these amounts:
  - (a) the asset's \*cost base at that time;
  - (b) the asset's cost;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-230

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- (c) the asset's market value immediately before the most recent time (if any), since the \*losing entity \*acquired the asset, when an \*affected owner has acquired:
  - (i) a \*primary equity interest in the losing entity; or
  - (ii) an \*indirect primary equity interest in the losing entity.
- (4) A \*primary equity interest in an entity is an ***indirect primary equity interest*** in another entity if, and only if:
  - (a) the first entity owns a primary equity interest in the other entity; or
  - (b) the first entity owns a primary equity interest that is an indirect primary equity interest in the other entity because of one or more other applications of this subsection.

**Indirect value shifts involving services****727-230 Services provided by losing entity to gaining entity for at least their direct cost**

An \*indirect value shift does not have consequences under this Division if:

- (a) to the extent of at least 95% of their total \*market value, the \*greater benefits consist entirely of:
  - (i) a right to have services that are covered by section 727-240 provided directly by the losing entity to the gaining entity; or
  - (ii) services that are covered by section 727-240 and have been, are being, or are to be, so provided;
 or both; and
- (b) there are \*lesser benefits and, as at the \*IVS time, the total market value of the lesser benefits is not less than the total of:
  - (i) the present value of the direct cost to the losing entity of providing the services; and
  - (ii) the present value of a reasonable allocation of the total direct cost to the losing entity of providing services that

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 727-235**

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include the first-mentioned services (so far as it is not already covered by subparagraph (i)).

To work out the costs and present values referred to in paragraph (b), see section 727-245.

**727-235 Services provided by gaining entity to losing entity for no more than a commercially realistic price**

- (1) An \*indirect value shift does not have consequences under this Division if:
- (a) there are \*lesser benefits and, to the extent of at least 95% of their total \*market value, the lesser benefits consist entirely of:
    - (i) a right to have services that are covered by section 727-240 provided directly by the gaining entity to the losing entity; or
    - (ii) services that are covered by section 727-240 and have been, are being, or are to be, so provided;or both; and
  - (b) as at the \*IVS time, the total market value of the greater benefits is not more than the total of:
    - (i) the present value of the direct cost to the gaining entity of providing the services; and
    - (ii) the present value of a reasonable allocation of the total direct cost to the gaining entity of providing services that include the first-mentioned services (so far as it is not already covered by subparagraph (i)); and
    - (iii) the present value of a reasonable allocation of the indirect cost to the gaining entity of providing the first-mentioned services; and
    - (iv) the mark-up worked out under subsection (2) or (3) of this section.

To work out the costs and present values referred to in paragraph (1)(b), see section 727-245.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 727-240**

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- (2) If it is reasonable to estimate that an entity providing the same quantity of services of the same kind in the same market would charge for them on the basis of a particular percentage mark-up, or on the basis of a percentage mark-up within a particular range, the mark-up for the purposes of subparagraph (1)(b)(iv) is:
- the total of the respective present values of the costs mentioned in subparagraphs (1)(b)(i), (ii) and (iii);
- multiplied by:
- that percentage mark-up, or the highest percentage in that range.
- (3) Otherwise, the mark-up for the purposes of subparagraph (1)(b)(iv) is 10% of the total of the respective present values of the costs mentioned in subparagraphs (1)(b)(i), (ii) and (iii).

**727-240 What services certain provisions apply to**

- (1) Sections 727-230, 727-235, 727-700 and 727-725 apply only to services consisting of:
- (a) doing work (including professional work and giving professional advice or any other kind of advice); or
- Note: Examples include accounting or legal services; advertising services and financial management services.
- (b) providing (including allowing use of) facilities for entertainment, recreation or instruction; or
  - (c) leasing, renting, hiring, or allowing the use of, any asset; or
  - (d) packaging, transporting or storing any property; or
  - (e) providing insurance; or
  - (f) services provided, by a banker to a customer, in the course of the banker carrying on the business of banking; or
  - (g) lending money or providing any other form of financial accommodation.
- (2) It does not matter whether services covered by paragraph (1)(a) also involve supplying property.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 727-245**

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**727-245 How to work out certain amounts for the purposes of sections 727-230 and 727-235**

- (1) The costs mentioned in paragraph 727-230(b) or 727-235(1)(b) are to be worked out:
  - (a) in accordance with generally accepted accounting practices; and
  - (b) to the extent that the services are to be provided in the future, on the basis of a reasonable estimate of those costs.
- (2) To avoid doubt, the direct cost or indirect cost mentioned in paragraph 727-230(b) or 727-235(1)(b) does *not* include:
  - (a) to the extent that the services consist of or include lending money or providing any other form of financial accommodation—the amount of the loan or other accommodation; or
  - (b) to the extent that the services consist of or include leasing, renting, hiring, or allowing the use of, any asset:
    - (i) the cost of acquiring the asset; or
    - (ii) the cost of acquiring an interest in, or right in respect of, the asset in order to provide the services.

**Example:** Acme Ltd is the holding company of Group Financier Pty Ltd. Group Financier Pty Ltd borrows \$20 million at 7% per annum, and on lends it to other subsidiaries of Acme Ltd at 8% per annum.

The \$20 million does not form part of Group Financier Pty Ltd's direct cost of the services it provides to the other subsidiaries in the form of the on lending. However, the 7% interest that Group Financier Pty Ltd pays on the \$20 million does form part of that direct cost.

- (3) The present values mentioned in paragraph 727-230(b) or 727-235(1)(b) are to be worked out using a discount rate equal to the rate that, for the purposes of section 109N of *Income Tax Assessment Act 1936*, is the benchmark interest rate for the income year in which the \*IVS time occurs.

**Note:** That section is about distributions to entities connected with a private company.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Anti-overlap provisions****727-250 Distribution by an entity to a member or beneficiary**

- (1) An \*indirect value shift does not have consequences under this Division if:
- (a) the \*greater benefits consist entirely of:
    - (i) a distribution of income or capital that the \*losing entity makes to the \*gaining entity; or
    - (ii) a right to a distribution of income or capital that the losing entity is to make to the gaining entity; because the gaining entity holds \*primary equity interests in the losing entity; and
  - (b) either:
    - (i) an amount covered by one or more of subsections (2), (3) and (4); or
    - (ii) the total of 2 or more such amounts; equals or exceeds the amount of the distribution.

*Conditions*

- (2) This subsection covers an amount that the assessable income or exempt income of the gaining entity for any income year includes because of the distribution or right.
- (3) This subsection covers an amount by which the \*cost base or \*reduced cost base (or both) of some or all of the \*primary equity interests referred to in subsection (1) changes because of the distribution or right.
- (4) This subsection covers an amount that, because of the distribution or right, is taken into account:
  - (a) under section 116-20 in working out the \*capital proceeds of a \*CGT event that happens during any income year to some or all of the \*primary equity interests referred to in subsection (1); or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 727-260**

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- (b) in working out a \*capital gain that an entity makes from CGT event E4 or G1 happening during any income year to some or all of those primary equity interests; or
- (c) in working out whether a loss or gain is \*realised for income tax purposes by a \*realisation event that happens to some or all of those primary equity interests (in their character as \*trading stock or \*revenue assets).

*Application of section to deemed dividend*

- (5) If a \*corporate tax entity makes a \*distribution that is not otherwise a distribution of income or capital, this section applies as if the distribution were a distribution of income or capital the entity made.

Note: Subsection (5) extends this section to cover something that is taken to be a dividend paid by a company. Compare item 1 of the table in subsection 960-120(1).

**Miscellaneous**

**727-260 Shift down a wholly-owned chain of entities**

- (1) An \*indirect value shift does not have consequences under this Division if the \*gaining entity is a \*wholly-owned subsidiary of the \*losing entity throughout the \*IVS period.

*Exception: impact on market value of primary loan interest*

- (2) However, subsection (1) does not apply if the \*indirect value shift has produced a \*disaggregated attributable decrease, in the \*market value of an \*affected interest in the \*losing entity that is also a \*primary loan interest in an entity covered by subsection (3), for the owner of the interest.
- (3) This subsection covers:
  - (a) the \*losing entity; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) an entity that owns \*primary equity interests in an entity that this subsection covers because of one or more previous applications of it.

### **Subdivision 727-D—Working out the market value of economic benefits**

#### **Table of sections**

727-300	What the rules in this Subdivision are for
727-315	Transfer, for its adjustable value, of depreciating asset acquired for less than \$1,500,000

#### **727-300 What the rules in this Subdivision are for**

This Subdivision is used in determining whether there has been an \*indirect value shift and, if so:

- (a) whether it has consequences under this Division; and
- (b) if it does, the amount of it.

#### **727-315 Transfer, for its adjustable value, of depreciating asset acquired for less than \$1,500,000**

- (1) This Division applies to an economic benefit consisting of:
  - (a) an entity transferring to another entity a \*depreciating asset (except a building or structure) for which the transferring entity has deducted or can deduct an amount under Division 40; or
  - (b) a right to have an entity transfer such a depreciating asset to another entity;
 as if the economic benefit's \*market value were equal to the greater (the *residual value*) of:
  - (c) the asset's \*adjustable value at the time when the economic benefit was or is \*provided; and
  - (d) the value assigned to the asset at that time in the transferring entity's books;
 but only if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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#### Section 727-315

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- (e) as at that time, the \*cost of the unit to the transferring entity is less than \$1,500,000; and
  - (f) it is reasonable for the transferring entity to conclude that the unit's actual market value at that time was, is, or will be, not less than 80%, and not more than 120%, of the residual value; and
  - (g) both the transferring entity and the other entity choose to have the market value of that economic benefit treated as being equal to the residual value.
- (2) If:
- (a) each of 2 or more economic benefits of the kind mentioned in subsection (1) has been, is being, is to be, or might be, provided by the same transferring entity, to the same other entity, \*in connection with the same \*scheme; and
  - (b) it is reasonable for the transferring entity to conclude that the total of the \*depreciating assets' actual \*market values at the respective times when the economic benefits were or are \*provided was, is, or will be, not less than 80%, and not more than 120%, of the total of their respective residual values under subsection (1);
- paragraph (1)(f) is taken to be satisfied for each of the economic benefits.

### Subdivision 727-E—Key concepts

#### Table of sections

##### Ultimate controller

727-350	<i>Ultimate controller</i>
727-355	<i>Control (for value shifting purposes)</i> of a company
727-360	<i>Control (for value shifting purposes)</i> of a fixed trust
727-365	<i>Control (for value shifting purposes)</i> of a non-fixed trust
727-370	Preventing double counting for percentage stake tests
727-375	Tests in this Subdivision are exhaustive

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-350

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**Common-ownership nexus and ultimate stake of a particular percentage**

- 727-400 When 2 entities have a common-ownership nexus within a period
- 727-405 *Ultimate stake* of a particular percentage in a company
- 727-410 *Ultimate stake* of a particular percentage in a fixed trust
- 727-415 Rules for tracing

**Ultimate controller****727-350 *Ultimate controller***

An entity is an ***ultimate controller*** of another entity if, and only if:

- (a) the first entity <sup>\*</sup>controls (for value shifting purposes) the other entity; and
- (b) there is no entity that controls (for value shifting purposes) both the first entity and the other entity.

**727-355 *Control (for value shifting purposes) of a company****50% stake test*

- (1) An entity ***controls (for value shifting purposes)*** a company if the entity, or the entity and its <sup>\*</sup>associates between them:
  - (a) can exercise, or can control the exercise of, at least 50% of the voting power in the company (either directly, or indirectly through one or more interposed entities); or
  - (b) have the right to receive (either directly, or indirectly through one or more interposed entities) at least 50% of any dividends that the company may pay; or
  - (c) have the right to receive (either directly, or indirectly through one or more interposed entities) at least 50% of any distribution of capital of the company.

*40% stake test*

- (2) An entity also ***controls (for value shifting purposes)*** a company if the entity, or the entity and its <sup>\*</sup>associates between them:

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<sup>\*</sup>To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) can exercise, or can control the exercise of, at least 40% of the voting power in the company (either directly, or indirectly through one or more interposed entities); or
  - (b) have the right to receive (either directly, or indirectly through one or more interposed entities) at least 40% of any dividends that the company may pay; or
  - (c) have the right to receive (either directly, or indirectly through one or more interposed entities) at least 40% of any distribution of capital of the company;
- unless an entity (other than the first entity and its associates) either alone or together with its associates in fact controls the company.

*Actual control test*

- (3) An entity also **controls (for value shifting purposes)** a company if the entity, either alone or together with its \*associates, in fact controls the company.

**727-360 Control (for value shifting purposes) of a fixed trust**

*40% stake test*

- (1) An entity **controls (for value shifting purposes)** a \*fixed trust if the entity, or the entity and its \*associates between them, have the right to receive (either directly, or indirectly through one or more interposed entities) at least 40% of any distribution of trust income, or trust capital, to beneficiaries of the trust.

*Other tests*

- (2) An entity also **controls (for value shifting purposes)** a \*fixed trust if:
  - (a) the entity, or an \*associate of the entity, whether alone or with other associates (the **relevant entity**), has the power to obtain the beneficial enjoyment of the trust's capital or income (whether or not by exercising its power of appointment or revocation, and whether with or without another entity's consent); or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the relevant entity is able to control the application of the trust's capital or income in any manner (whether directly or indirectly); or
- (c) the relevant entity is able to do a thing mentioned in paragraph (a) or (b) under a \*scheme; or
- (d) a trustee of the trust is accustomed or is under an obligation (whether formally or informally), or might reasonably be expected, to act in accordance with the relevant entity's directions, instructions or wishes; or
- (e) the relevant entity is able to remove or appoint a trustee of the trust.

**727-365 Control (for value shifting purposes) of a non-fixed trust***Trustee tests*

- (1) An entity **controls (for value shifting purposes)** a \*non-fixed trust if:
  - (a) the entity or an \*associate of the entity is a trustee of the trust; or
  - (b) the entity, or the entity and its \*associates between them, can remove or appoint the trustee, or one or more of the trustees, of the trust; or
  - (c) a trustee of the trust is accustomed to act, is under an obligation (whether formally or informally) to act, or might reasonably be expected to act, in accordance with the directions, instructions or wishes of:
    - (i) the entity or an \*associate of the entity; or
    - (ii) 2 or more entities, at least one of which is the entity or an associate of the entity.

*Tests based on control of the trust income or capital*

- (2) An entity also **controls (for value shifting purposes)** a \*non-fixed trust if the entity, or the entity and its \*associates between them:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) have the power to obtain the beneficial enjoyment of trust income or capital; or
  - (b) can control in any way at all, whether directly or indirectly, the application of trust income or capital; or
  - (c) can, under a \*scheme, gain the enjoyment or control referred to in paragraph (a) or (b).
- (3) An entity also ***controls (for value shifting purposes)*** a \*non-fixed trust if:
- (a) the entity, or any of its \*associates, can benefit under the trust otherwise than because of a \*fixed entitlement to a share of the income or capital of the trust; or
  - (b) if the entity, or the entity and its \*associates between them, have the right to receive (either directly, or indirectly through one or more interposed entities) at least 40% of any distribution of trust income, or trust capital.

**727-370 Preventing double counting for percentage stake tests**

If an interest giving an entity, or an entity and its \*associates:

- (a) the ability to exercise, or control the exercise of, any of the voting power in a company; or
- (b) the right to receive dividends that a company may pay; or
- (c) the right to receive a distribution of capital of a company; or
- (d) the right to receive a distribution of trust income or trust capital;

is both direct and indirect, and (apart from this section) would be counted more than once in applying subsection 727-355(1) or (2) or section 727-360, only the direct interest is to be counted.

**727-375 Tests in this Subdivision are exhaustive**

An entity does not ***control (for value shifting purposes)*** a company or trust except as provided in this Subdivision.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Common-ownership nexus and ultimate stake of a particular percentage

### 727-400 When 2 entities have a common-ownership nexus within a period

- (1) 2 entities have a **common-ownership nexus** within a period if, and only if, they satisfy the test in any of the one or more items in the table applicable to them.

Common-ownership nexus within a period		
Item	If the entities are:	This is the test:
1	both companies	<p>There must be 2 or more *ultimate owners who:</p> <p>(a) at some time during that period, because of the same test in section 727-405, have *ultimate stakes, of percentages totalling at least 80%, in one of the companies; and</p> <p>(b) at that or a different time during that period, because of that same test, have *ultimate stakes, of percentages totalling at least 80%, in the other company</p> <p>Also, subsection (2) of this section must be satisfied</p>
2	both *fixed trusts	<p>There must be 2 or more *ultimate owners who:</p> <p>(a) at some time during that period, because of the same test in section 727-410, have *ultimate stakes, of percentages totalling at least 80%, in one of the trusts; and</p> <p>(b) at that or a different time during that period, because of that same test, have *ultimate stakes, of percentages totalling at least 80%, in the other trust</p> <p>Also, subsection (2) of this section must be satisfied</p>

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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##### Common-ownership nexus within a period

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Item	If the entities are:	This is the test:
3	a company and a *fixed trust	There must be 2 or more *ultimate owners who: (a) at some time during that period, because of the same test in section 727-405, have *ultimate stakes, of percentages totalling at least 80%, in the company; and (b) at that or a different time during that period, because of the same test in section 727-410, have *ultimate stakes, of percentages totalling at least 80%, in the trust Also, subsection (2) of this section must be satisfied
4	a company and a *non-fixed trust	There must be 2 or more *ultimate owners: (a) each of whom *controls (for value shifting purposes) the non-fixed trust because of section 727-365 at the same time during that period; and (b) who, at that or a different time during that period, have *ultimate stakes, of percentages totalling at least 80%, in the company because of the same test in section 727-405
5	a *fixed trust and a *non-fixed trust	There must be 2 or more *ultimate owners: (a) each of whom *controls (for value shifting purposes) the non-fixed trust because of section 727-365 at the same time during that period; and (b) who, at that or a different time during that period, have *ultimate stakes, of percentages totalling at least 80%, in the fixed trust because of the same test in section 727-410

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*Additional condition about profile of percentage ultimate stakes held by 2 or more ultimate owners*

- (2) In order to satisfy the test in item 1, 2 or 3 in the table in subsection (1), at least one of subsections (3), (4) and (5) must be satisfied.
- (3) For at least one of the \*ultimate owners referred to in that item, the percentage of the \*ultimate stake that owner has as mentioned in

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-405

paragraph (a) in the last column of that item must be at least 40%, and so must the percentage of the ultimate stake that owner has as mentioned in paragraph (b) in the last column of that item.

- (4) Alternatively, for *each* of those \*ultimate owners, the percentage of the \*ultimate stake that owner has as mentioned in that paragraph (a) must be the same as the percentage of the ultimate stake that owner has as mentioned in that paragraph (b).
- (5) Alternatively, the number of those \*ultimate owners must not exceed 16.

**727-405 Ultimate stake of a particular percentage in a company**

- (1) This section sets out 3 tests of whether an entity has an *ultimate stake* of a particular percentage (the *test percentage*) in a company.

Note: In applying the tests, follow the rules in section 727-415.

*Voting power*

- (2) The first test is that, after tracing, to the \*ultimate owners who ultimately hold it, the direct and indirect ownership of all \*shares in the company that carry the right to exercise voting power in the company, that ownership is held by the entity to the extent of the test percentage of that voting power.

*Dividends*

- (3) The second test is that, after tracing, to the \*ultimate owners who ultimately hold it, the direct and indirect ownership of all \*shares in the company that carry the right to receive any dividends that the company may pay, that ownership is held by the entity to the extent of the test percentage of those dividends.

*Capital distributions*

- (4) The third test is that, after tracing, to the \*ultimate owners who ultimately hold it, the direct and indirect ownership of all \*shares in the company that carry the right to receive any distribution of

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 727-410**

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capital of the company, that ownership is held by the entity to the extent of the test percentage of the distribution.

*Certain shares ignored*

- (5) In tracing the ownership of \*shares in a company, ignore \*shares whose \*dividends can reasonably be regarded as being equivalent to the payment of interest on a loan having regard to:
- (a) how the dividends are calculated; and
  - (b) the conditions applying to the payment of the dividends; and
  - (c) any other relevant matters.

**727-410 Ultimate stake of a particular percentage in a fixed trust**

- (1) This section sets out 2 tests of whether an entity has an **ultimate stake** of a particular percentage (the **test percentage**) in a \*fixed trust.

Note: In applying the tests, follow the rules in section 727-415.

*Income distributions*

- (2) The first test is that, after tracing, to the \*ultimate owners who ultimately hold them, the direct and indirect rights to receive distributions of trust income, those rights are held by the entity to the extent of the test percentage of each such distribution.

*Capital distributions*

- (3) The second test is that, after tracing, to the \*ultimate owners who ultimately hold them, the direct and indirect rights to receive distributions of trust capital, those rights are held by the entity to the extent of the test percentage of each such distribution.

**727-415 Rules for tracing**

- (1) In applying sections 727-400, 727-405 and 727-410, follow the rules in this section.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Interposed entities*

- (2) Tracing is to be done through any interposed entities.

*Ownership or rights held jointly*

- (3) If some of the ownership or rights of a particular kind in relation to a company or trust are held by 2 or more entities jointly or in common, each of the entities is treated as holding a proportion of the ownership or rights so held. The proportion is to be worked out on a reasonable basis, so that the total of the proportions equals the total of the ownership or rights so held.

*Ownership or rights held by associate*

- (4) If, at a particular time:
- (a) an \*ultimate owner is an \*associate of another ultimate owner; and
  - (b) the associate ultimately holds some of the ownership or rights of a particular kind in relation to a company or trust;
- then, in determining whether the other ultimate owner is one of 2 or more ultimate owners because of whom the conditions in an item in the table in section 727-400 are satisfied, the ownership or rights of that kind in relation to the company or trust held by the associate at that time:
- (c) to the extent of a particular percentage, may be treated as being instead held by the other ultimate owner; and
  - (d) to the extent so treated, cannot be treated as being instead held by any other ultimate owner of whom the first ultimate owner is an associate.
- (5) If one or more applications of subsection (4) are necessary to establish that an \*ultimate owner is one of 2 or more ultimate owners because of whom the conditions in an item in the table in section 727-400 are satisfied, that subsection must be applied accordingly.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 727-450

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**Subdivision 727-F—Consequences of an indirect value shift**

**Guide to Subdivision 727-F**

**727-450 What this Subdivision is about**

This Subdivision tells you:

- which method to use to work out the consequences of an indirect value shift for equity or loan interests, and indirect equity or loan interests, in the losing entity and in the gaining entity; and
- which interests, and which owners, are affected.

**Table of sections**

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727-460 *Affected interests* in the losing entity

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727-550 Choosing the adjustable value method

727-555 Giving other affected owners information about the choice

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Operative provisions****727-455 Consequences of the indirect value shift**

The consequences (if any) of an \*indirect value shift must be worked out using the \*realisation time method unless the \*adjustable value method is chosen in accordance with section 727-550.

Note: Later provisions of this Subdivision set out the interests to which those consequences apply (see sections 727-460 to 727-525), which are in turn determined by who are the affected owners (see section 727-530).

**Affected interests****727-460 *Affected interests in the losing entity***

These are the ***affected interests*** in the \*losing entity:

- (a) each \*equity or loan interest that an \*affected owner owns in the losing entity immediately before the \*IVS time; and
- (b) each equity or loan interest that:
  - (i) an affected owner owns in another affected owner immediately before the IVS time; and
  - (ii) is an \*indirect equity or loan interest in the losing entity;(except one covered by an exception in section 727-470).

**727-465 *Affected interests in the gaining entity***

If immediately before the \*IVS time the \*gaining entity is a company or trust (except one listed in section 727-125 (about superannuation entities)), these are the ***affected interests*** in the gaining entity:

- (a) each \*equity or loan interest that an \*affected owner owns in the gaining entity immediately before the \*IVS time; and
- (b) each equity or loan interest that:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Chapter 3** Specialist liability rules

**Part 3-95** Value shifting

**Division 727** Indirect value shifting affecting interests in companies and trusts, and arising from non-arm's length dealings

**Section 727-470**

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- (i) an affected owner owns in another affected owner immediately before the IVS time; and
  - (ii) is an \*indirect equity or loan interest in the gaining entity;
- (except one covered by an exception in section 727-470).

**727-470 Exceptions**

*Mere active participants*

- (1) An \*equity or loan interest that an \*active participant in the \*scheme owns in another active participant immediately before the \*IVS time is not an \*affected interest in the \*losing entity or in the \*gaining entity unless one of the active participants is also covered by 1, 2, 3 or 4 in the table in subsection 727-530(1) (about who is an affected owner).

*Entity that is a small business entity, or satisfies the maximum net asset value test for small business relief*

- (2) An \*equity or loan interest that an entity (the **owner**) owns immediately before the \*IVS time is not an \*affected interest in the \*losing entity or in the \*gaining entity if the owner:
  - (a) is a \*small business entity for each income year that includes any of the \*IVS period; or
  - (b) would satisfy the maximum net asset value test in section 152-15 throughout the \*IVS period.
- (3) If the owner is not in existence for part of the \*IVS period, disregard that part in applying subsection (2).

*Interests in superannuation entities not covered*

- (4) An \*equity or loan interest in an \*affected owner is not an \*affected interest in the \*losing entity or in the \*gaining entity if the affected owner is an entity listed in section 727-125 (about superannuation entities) in relation to the income year in which the \*IVS time happens.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



**727-520 Equity or loan interest and related terms**

- (1) An **equity or loan interest** in an entity is a \*primary interest, or a \*secondary interest, in the entity.
- (2) A **primary interest** in an entity is a \*primary equity interest, or a \*primary loan interest, in the entity.
- (3) The meaning of **primary equity interest** in an entity is set out in the table.

<b>Primary equity interests</b>		
<b>Item</b>	<b>In the case of this kind of entity:</b>	<b>Primary equity interest means:</b>
1	a company	a *share in the company; or an interest as joint owner (including as tenant in common) of a *share in the company
2	a trust	any of these: (a) an interest in the trust income or trust capital; or (b) any other interest in the trust; or (c) an interest as joint owner (including as tenant in common) of an interest covered by paragraph (a) or (b)

- (4) A **primary loan interest** in an entity is:
  - (a) a loan to the entity; or
  - (b) an interest as joint owner (including as tenant in common) of a loan to the entity.
- (5) A **secondary interest** in an entity is a \*secondary equity interest, or a \*secondary loan interest, in the entity.
- (6) A **secondary equity interest** in an entity is a right or option:
  - (a) to \*acquire an existing \*primary equity interest in the entity; or
  - (b) to have the entity issue a new primary equity interest.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 727-525

- (7) A **secondary loan interest** in an entity is a right or option:
- (a) to \*acquire an existing \*primary loan interest in the entity; or
  - (b) to have the entity issue a new primary loan interest.

**727-525 Indirect equity or loan interest**

An \*equity or loan interest in an entity is an **indirect equity or loan interest** in another entity if, and only if:

- (a) the first entity owns an equity or loan interest in the other entity; or
- (b) the first entity owns an equity or loan interest that is an indirect equity or loan interest in the other entity because of one or more other applications of this section.

**Affected owners**

**727-530 Who are the affected owners**

- (1) The table sets out the **affected owners** for the \*indirect value shift.

Affected owners		
Item	In this case:	The affected owners include:
1	At least one condition in section 727-105 (ultimate controller test) is satisfied	each *ultimate controller because of which a condition in that section is satisfied; and each entity that, at a time during the *IVS period when such an ultimate controller *controlled (for value shifting purposes) the <i>losing</i> entity, was an *intermediate controller of the <i>losing</i> entity; and each entity that, at a time during the IVS period when such an ultimate controller controlled (for value shifting purposes) the <i>gaining</i> entity, was an intermediate controller of the <i>gaining</i> entity

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 727-530

**Affected owners**

<b>Item</b>	<b>In this case:</b>	<b>The affected owners include:</b>
2	The conditions in section 727-110 (common-ownership nexus test) are satisfied in respect of: (a) one or more times; or (b) one or more sets of 2 times	each *ultimate owner who is one of 2 or more ultimate owners because of whom the condition in the applicable item of that table is satisfied in respect of any of those times; and each entity through which ownership or rights are traced to such an ultimate owner in applying the applicable item of that table in respect of any of those times
3	Any case	the *losing entity and the *gaining entity
4	Any case	each entity that, at any time after the *scheme was entered into, is an *associate of an entity that is an affected owner because of item 1, 2 or 3 of this table
5	Any case	each *active participant in the *scheme

- (2) An entity is an **intermediate controller** of another entity if, and only if:
- (a) the first entity \*controls (for value shifting purposes) the other entity; and
  - (b) the first entity is \*controlled (for value shifting purposes) by an \*ultimate controller of the other entity.

*Active participants (if both losing and gaining entities are closely held)*

- (3) An entity (the **first entity**) is an **active participant** in the \*scheme if:
- (a) at some time during the \*IVS period, neither the losing entity nor the gaining entity has 300 or more members (in the case of a company) or 300 or more beneficiaries (in the case of a trust); and
  - (b) the first entity:

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Chapter 3 Specialist liability rules

### Part 3-95 Value shifting

**Division 727** Indirect value shifting affecting interests in companies and trusts, and arising from non-arm's length dealings

#### Section 727-550

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- (i) actively participated in, or directly facilitated, the entering into of the \*scheme; or
- (ii) at some time during the \*IVS period actively participated in, or directly facilitated, the carrying out of the scheme;  
(whether or not it did so at the direction of some other entity); and
- (c) at some time during the \*IVS period, the first entity owned:
  - (i) an \*equity or loan interest in the losing entity or in the gaining entity; or
  - (ii) an \*indirect equity or loan interest in the losing entity or in the gaining entity; and
- (d) the first entity is neither the losing entity nor the gaining entity.

Note: Subsections 727-110(2) and (3) contain rules about when an entity is treated as having or not having 300 or more members or beneficiaries.

### Choices about method to be used

#### 727-550 Choosing the adjustable value method

- (1) This section sets out rules for:
  - (a) choosing to use the \*adjustable value method to work out the consequences of an \*indirect value shift; or
  - (b) choosing (when using the adjustable value method) *not* to work out on a \*loss-focussed basis the reductions in the \*adjustable values of \*affected interests.

#### *Who makes the choice*

- (2) The choice must be made in accordance with the table.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 727-550

<b>Who makes the choice</b>		
<b>Item</b>	<b>In this case:</b>	<b>The choice must be made by:</b>
1	If the conditions in section 727-110 (common-ownership nexus test) are satisfied	jointly by the *ultimate owners because of whom the condition in the applicable item of the table in section 727-400 is satisfied
2	Item 1 does not apply, and there is an entity: (a) who is the sole *ultimate controller because of whom the conditions in section 727-105 (ultimate controller test) are satisfied; or (b) who would be that sole ultimate controller if sections 727-355 to 727-375 were applied ignoring that entity's *associates	that entity
3	Neither of items 1 and 2 applies	jointly by the 2 or more *ultimate controllers because of whom the conditions in section 727-105 (ultimate controller test) are satisfied

*When choice must be made*

- (3) The choice must be made within 2 years after the *first* \*realisation event that happens to an \*affected interest at or after the IVS time.

*Choice binds all affected owners*

- (4) The choice binds all \*affected owners for the \*indirect value shift.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 727-555**

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**727-555 Giving other affected owners information about the choice**

- (1) An entity that makes a choice under section 727-550 (including a choice made jointly with one or more other entities) must inform all entities that it knows to be \*affected owners for the \*indirect value shift about the content of the choice. The entity must do so in writing within one month after making the choice.

Penalty: 30 penalty units.

- (2) If:
- (a) a choice under section 727-550 is made jointly by 2 or more entities; and
  - (b) one of the entities complies with subsection (1);
- no other entity need comply with that subsection in relation to that choice.
- (3) If an \*affected owner for an \*indirect value shift has reason to believe that an entity may have made a choice under section 727-550 (including a choice made jointly with one or more other entities), the affected owner may give the entity a written notice asking whether the entity has made such a choice.
- (4) Within one month after receiving a notice under subsection (3), an entity must inform the \*affected owner in writing whether the entity has made a choice under section 727-550 and, if so, about the content of the choice.

Penalty: 30 penalty units.

- (5) The Commissioner may extend the period for complying with a provision of this section.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Subdivision 727-G—The realisation time method

### 727-600 What this Subdivision is about

Under the realisation time method:

- losses on realisation of affected interests in the losing entity are reduced; and
- gains on realisation of affected interests in the gaining entity are reduced, within limits worked out by reference to the reductions in losses on affected interests in the losing entity; and
- certain 95% services indirect value shifts are disregarded.

This Subdivision also explains how its reduction of a loss or gain affects CGT assets, trading stock and revenue assets.

### Table of sections

#### Operative provisions

727-610	Consequences of indirect value shift
727-615	Reduction of loss on realisation event for affected interest in losing entity
727-620	Reduction of gain on realisation event for affected interest in gaining entity
727-625	Total gain reductions not to exceed total loss reductions
727-630	How cap in section 727-625 applies if affected interest is also trading stock or a revenue asset
727-635	Splitting an equity or loan interest
727-640	Merging equity or loan interests
727-645	Effect of CGT roll-over

#### Further exclusion for certain 95% services indirect value shifts if realisation time method must be used

727-700	When 95% services indirect value shift is excluded
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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Chapter 3 Specialist liability rules

### Part 3-95 Value shifting

**Division 727** Indirect value shifting affecting interests in companies and trusts, and arising from non-arm's length dealings

#### Section 727-610

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##### **95% services indirect value shifts that are *not* excluded**

- 727-705 Another provision of the income tax law affects amount related to services by at least \$100,000
- 727-710 Ongoing or recent service arrangement reduces value of losing entity by at least \$100,000
- 727-715 Service arrangements reduce value of losing entity that *is* a group service provider by at least \$500,000
- 727-720 Abnormal service arrangement reduces value of losing entity that is *not* a group service provider by at least \$500,000
- 727-725 Meaning of *predominantly-services indirect value shift*

### Operative provisions

#### **727-610 Consequences of indirect value shift**

- (1) This Subdivision sets out the *realisation time method* of working out the consequences (if any) of an \*indirect value shift.
- (2) If those consequences are to be worked out using that method, this Subdivision applies to each \*realisation event:
  - (a) by which a loss would, apart from this Division, be \*realised for income tax purposes; and
  - (b) that happens to an \*affected interest in the \*losing entity; and
  - (c) that is the first realisation event that happens to that interest at or after the \*IVS time; and
  - (d) that happens:
    - (i) if the amount of the indirect value shift is \$500,000 or more—at any time after the IVS time; or
    - (ii) otherwise—within 4 years after the IVS time.
- (3) If:
  - (a) those consequences are to be worked out using that method; and
  - (b) the \*gaining entity is a company or trust (except one listed in section 727-125 (about superannuation entities)) immediately before the \*IVS time;this Subdivision applies to each \*realisation event:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



**Section 727-615**

- (c) by which a gain would, apart from this Division, be \*realised for income tax purposes; and
  - (d) that happens to an \*affected interest in the \*gaining entity; and
  - (e) that is the first realisation event that happens to that interest at or after the IVS time.
- (4) The consequences for the \*affected interest depend on its character. There are consequences for the interest in its character as a \*CGT asset. However, if the interest is also \*trading stock or a \*revenue asset, there are additional consequences for it in that character.
- (5) In working out the consequences for an \*affected interest in the \*losing entity or \*gaining entity, in the interest's character as \*trading stock, a \*realisation event is disregarded for the purposes of identifying under paragraph (2)(c) or (3)(e) the first realisation event that happens to that interest at or after the \*IVS time, if:
- (a) the realisation event consists of the ending of an income year; and
  - (b) the \*value of the interest as trading stock on hand of an entity at the end of the income year is the interest's \*cost; and
  - (c) the interest became part of the entity's trading stock on hand during that income year, or the value of the interest as trading stock of the entity on hand at the start of the income year was also the interest's cost.

**727-615 Reduction of loss on realisation event for affected interest in losing entity**

If this Subdivision applies to a \*realisation event that happens to an \*affected interest in the \*losing entity, a loss that would, apart from this Division, be \*realised for income tax purposes by the event is reduced by an amount that is reasonable having regard to:

- (a) a reasonable estimate of the amount (if any) by which the \*indirect value shift has reduced the interest's \*market value; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 727-620

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- (b) if the interest is also an affected interest in the \*gaining entity—a reasonable estimate of the extent (if any) to which the interest's market value at the time of the realisation event still reflects the effect of the indirect value shift on the market value of \*equity or loan interests in the gaining entity.

**727-620 Reduction of gain on realisation event for affected interest in gaining entity**

If this Subdivision applies to a \*realisation event that happens to an \*affected interest in the \*gaining entity, a gain that would, apart from this Division, be \*realised for income tax purposes by the event is reduced by an amount that is reasonable having regard to:

- (a) a reasonable estimate of the amount (if any) by which the \*indirect value shift has increased the interest's \*market value; and
- (b) a reasonable estimate of the extent (if any) to which the interest's market value at the time of the realisation event still reflects the effect of the indirect value shift on the market value of \*equity or loan interests in the gaining entity.

**727-625 Total gain reductions not to exceed total loss reductions**

- (1) This section ensures that the total (***total gain reductions***) of the amounts by which section 727-620 reduces gains \*realised for income tax purposes by \*realisation events happening at the same time does not exceed the total (***total loss reductions***) of:
  - (a) the amounts by which section 727-615 reduces losses that:
    - (i) would, apart from this Division, be \*realised for income tax purposes by \*realisation events happening before or at that time; and
    - (ii) have not already been taken into account in a previous application of this section; and
  - (b) the amounts by which section 727-850 (as applying to the \*scheme from which the \*indirect value shift results) reduces losses that:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 727-630**

- (i) would, apart from this Division, be realised for income tax purposes by realisation events happening before the \*IVS time to \*equity or loan interests, or \*indirect equity or loan interests, in the \*losing entity; and
  - (ii) have not already been taken into account in a previous application of this section.
- (2) If, apart from this section, the total gain reductions would exceed the total loss reductions, the amount by which section 727-620 reduces each of the gains is itself reduced by the amount worked out using this formula:

$$\frac{(\text{Total gain reductions} - \text{Total loss reductions})}{\text{Number of interests}}$$

- (3) For the purposes of the formula:

***number of interests*** means the number of \*affected interests in the \*gaining entity to which \*realisation events happened at that time.

**727-630 How cap in section 727-625 applies if affected interest is also trading stock or a revenue asset**

- (1) This section affects how to work out the total gain reductions and the total loss reductions for the purposes of section 727-625 if:
- (a) a \*realisation event covered by that section happens to an \*equity or loan interest, or to an \*indirect equity or loan interest, in the \*losing entity or in the \*gaining entity; and
  - (b) the interest is also \*trading stock or a \*revenue asset at the time of the event.

***Trading stock***

- (2) In the case of an \*equity or loan interest, or an \*indirect equity or loan interest, in the \*losing entity that is \*trading stock at that time:
- (a) the amount (if any) by which section 727-615 or 727-850 reduces a loss worked out under section 977-25 or 977-30 (about realisation events for trading stock) that would, apart

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 727-630**

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from this Division, be \*realised for income tax purposes by the event is taken into account; and

- (b) the amount (if any) by which section 727-615 or 727-850 reduces a loss worked out under section 977-10 (about realisation events for CGT assets) that would, apart from this Division, be \*realised for income tax purposes by the event is *not* taken into account;

in working out the total loss reductions.

- (3) In the case of an \*affected interest in the \*gaining entity that is \*trading stock at that time:

- (a) the amount (if any) by which section 727-620 reduces a gain worked out under section 977-35 or 977-40 (about realisation events for trading stock) that would, apart from this Division, be \*realised for income tax purposes by the event is taken into account; and
- (b) the amount (if any) by which section 727-620 reduces a gain worked out under section 977-15 (about realisation events for CGT assets) that would, apart from this Division, be \*realised for income tax purposes by the event is *not* taken into account;

in working out the total gain reductions.

*Revenue asset*

- (4) In the case of an \*equity or loan interest, or an \*indirect equity or loan interest, in the \*losing entity that is a \*revenue asset at that time, the greater of the following is taken into account in working out the total loss reductions:

- (a) the amount (if any) by which section 727-615 or 727-850 reduces a loss worked out under section 977-55 (about realisation events for revenue assets) that would, apart from this Division, be \*realised for income tax purposes by the event;
- (b) the amount (if any) by which section 727-615 or 727-850 reduces a loss worked out under section 977-10 (about

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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realisation events for CGT assets) that would, apart from this Division, be \*realised for income tax purposes by the event.

- (5) In the case of an \*affected interest in the \*gaining entity that is a \*revenue asset at that time, the greater of the following amounts is taken into account in working out the total gain reductions:
- (a) the amount (if any) by which section 727-620 reduces a gain worked out under section 977-55 (about realisation events for revenue assets) that would, apart from this Division, be \*realised for income tax purposes by the event;
  - (b) the amount (if any) by which section 727-620 reduces a gain worked out under section 977-15 (about realisation events for CGT assets) that would, apart from this Division, be \*realised for income tax purposes by the event.

**727-635 Splitting an equity or loan interest**

If an \*equity or loan interest in the \*losing entity or in the \*gaining entity is split into 2 or more equity or loan interests at or after the \*IVS time:

- (a) each of the 2 or more interests inherits whatever characteristics would have been relevant to applying this Subdivision to the first interest if the split had not happened; and
- (b) those characteristics include characteristics the first interest has inherited because of any other application or applications of this section or section 727-640; and
- (c) if a characteristic of the first interest involves an amount or quantity, the amount or quantity for that characteristic as inherited by each of the 2 or more interests is a reasonable proportion of the amount or quantity for that characteristic of the first interest.

**727-640 Merging equity or loan interests**

If 2 or more \*equity or loan interests (the *original interests*) in the \*losing entity or in the \*gaining entity are merged into 1 or more

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 727-645**

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\*equity or loan interests (the *new interests*) at or after the \*IVS time:

- (a) each of the new interests inherits whatever characteristics would have been relevant to applying this Subdivision to the original interests if the merging had not happened; and
- (b) those characteristics include characteristics inherited by any of the original interests because of any other application or applications of this section or section 727-635; and
- (c) if a characteristic of any of the original interests involves an amount or quantity, the amount or quantity for that characteristic as inherited by any of the new interests is a reasonable proportion of the amount or quantity for that characteristic of the original interest.

**727-645 Effect of CGT roll-over**

(1) If:

- (a) this Subdivision applies to a \*realisation event that is a \*CGT event that happens to an \*affected interest in the \*losing entity; and
- (b) section 727-615 reduces a loss that would, apart from this Division, be \*realised for income tax purposes by the CGT event; and
- (c) there is a roll-over for the CGT event;

the interest's \*reduced cost base at the time of the CGT event is taken to have been reduced by the amount by which section 727-615 reduces that loss, but is so taken only for the purposes of working out:

- (d) the interest's reduced cost base, from time to time after the roll-over, for the entity that \*acquired the interest because of the CGT event; and
- (e) in the case of a \*replacement-asset roll-over—the reduced cost base of the replacement CGT asset, from time to time after the roll-over, for the entity that \*disposed of the interest.

Note: Because of the roll-over, the loss reduction under section 727-615 will have no tax effect. This subsection ensures that the loss reduction is

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 727-700**

passed on, through the reduction in reduced cost base, to prevent or reduce a loss arising on a later CGT event.

(2) If:

(a) this Subdivision applies to a \*realisation event that is a \*CGT event that happens to an \*affected interest in the \*gaining entity; and

(b) section 727-620 reduces a gain that would, apart from this Division, be \*realised for income tax purposes by the CGT event; and

(c) there is a roll-over for the CGT event;

the interest's \*cost base at the time of the CGT event is taken to have been uplifted by the amount by which section 727-620 reduces that gain, but is so taken only for the purposes of working out:

(d) the interest's cost base, from time to time after the roll-over, for the entity that \*acquired the interest because of the CGT event; and

(e) in the case of a \*replacement-asset roll-over—the cost base of the replacement CGT asset, from time to time after the roll-over, for the entity that \*disposed of the interest.

Note: Because of the roll-over, the gain reduction under section 727-620 will have no tax effect. This subsection ensures that the gain reduction is passed on, through the uplift in cost base, to prevent or reduce a gain arising on a later CGT event.

### **Further exclusion for certain 95% services indirect value shifts if realisation time method must be used**

#### **727-700 When 95% services indirect value shift is excluded**

(1) If the \*indirect value shift is a \*95% services indirect value shift, this Subdivision does not apply to a \*realisation event that:

(a) happens to an \*affected interest in the \*losing entity that is owned by an entity (the *owner*); and

(b) is covered by subsection 727-610(2);

unless:

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 727-705**

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- (c) the conditions in section 727-705 are met for the indirect value shift; or
  - (d) the conditions in section 727-710, 727-715 or 727-720 are met for the indirect value shift and for that realisation event.
- (2) An \*indirect value shift is a **95% services indirect value shift** if, and only if, to the extent of at least 95% of their total \*market value, the \*greater benefits consist entirely of:
  - (a) a right to have services that are covered by section 727-240 provided directly by the \*losing entity to the \*gaining entity; or
  - (b) services that are covered by section 727-240 and have been, are being, or are to be, so provided; or both.
- (3) This section does not limit any other exclusion in this Subdivision or in Subdivision 727-C.

**95% services indirect value shifts that are *not* excluded**

**727-705 Another provision of the income tax law affects amount related to services by at least \$100,000**

The conditions in this section are met if:

- (a) the \*losing entity or the \*gaining entity lodges an \*income tax return for an income year during some or all of which the owner owned the interest; and
- (b) a provision of this Act:
  - (i) reduces or excludes an amount that is included in the return; or
  - (ii) increases an amount that is so included; or
  - (iii) includes an amount not included in the return; for the purposes of working out the taxable income, a \*tax loss, or a \*net capital loss, of that entity for that income year; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



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Section 727-710

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- (c) the amount is related to the right mentioned in paragraph 727-700(2)(a), or to some or all of the services mentioned in paragraph 727-700(2)(a) or (b), from the point of view of the losing entity providing the services or of the gaining entity receiving them; and
- (d) if the amount is so reduced or increased—the reduction or increase is at least \$100,000; and
- (e) if the amount is so excluded or included—the amount is at least \$100,000; and
- (f) at some time after the return is lodged, the entity that lodged it is aware, or ought reasonably to be aware, of the reduction, exclusion, increase or inclusion.

Example: If the Commissioner has notified an entity affected by a determination under Part IVA of the *Income Tax Assessment Act 1936*, the entity ought reasonably to be aware of the effect of the determination.

### **727-710 Ongoing or recent service arrangement reduces value of losing entity by at least \$100,000**

- (1) Either or both of these must be true:
  - (a) when the \*realisation event mentioned in subsection 727-700(1) happens, some or all of the services mentioned in paragraph 727-700(2)(a) or (b) have not yet been provided; or
  - (b) some or all of those services have been provided in the income year (of the \*losing entity) in which the realisation event happens, or in the previous income year.
- (2) It must be reasonable to conclude that the total (the ***total market value***) of the \*market values, immediately before the \*realisation event, of \*primary interests in the \*losing entity then owned by \*affected owners is less than it would have been if none of the following had happened:
  - (a) the \*95% services indirect value shift; and
  - (b) all other \*predominantly-services indirect value shifts that satisfy subsection (1) (or that would satisfy it if they were \*95% services indirect value shifts).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-715

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- (3) It must also be reasonable to conclude that the total \*market value is less than it would have been by at least:
  - (a) \$100,000, if the total of the \*adjustable values, immediately before the \*realisation event, of the \*primary interests referred to in subsection (2) is less than or equal to \$2,000,000; or
  - (b) 5% of the total of those \*adjustable values, if that total is greater than \$2,000,000 and less than or equal to \$10,000,000; or
  - (c) \$500,000, if that total is greater than \$10,000,000.
- (4) For the purposes of subsections (2) and (3), disregard an \*indirect value shift referred to in paragraph (2)(a) or (b) if services are provided directly by the \*losing entity to the \*gaining entity under the \*scheme before the income year (of the losing entity) before the one in which the \*realisation event happened.

**727-715 Service arrangements reduce value of losing entity that is a group service provider by at least \$500,000**

- (1) At some time during the period (the *ownership period*) when the owner owned the interest, the sole or dominant activity of the \*losing entity must consist of providing services directly to one or more entities (the *group entities*) each of which is covered by one or more of the following paragraphs:
  - (a) the \*gaining entity;
  - (b) an \*affected owner;
  - (c) an entity that has at that time the same \*ultimate controller as the losing entity or the gaining entity;
  - (d) if the conditions in section 727-110 (common-ownership nexus test) are satisfied for the \*indirect value shift—an entity that has with the losing entity or with the gaining entity a \*common-ownership nexus within that period.
- (2) It must be reasonable to conclude that the total (the *total market value*) of the \*market values, immediately before the \*realisation event, of \*primary interests in the \*losing entity then owned by

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 727-715**

\*affected owners is less than it would have been if none of the following had happened:

- (a) the \*95% services indirect value shift; and
- (b) each \*predominantly-services indirect value shift for which the same entity is the losing entity as for the 95% services indirect value shift, and that happened:
  - (i) if the amount of the \*indirect value shift is \$500,000 or more—at any time during the ownership period; or
  - (ii) otherwise—during the ownership period but within 4 years before the realisation event, or at the same time as the realisation event.

*Thresholds for reduction of the total market value*

- (3) It must also be reasonable to conclude that the total \*market value is less than it would have been by at least \$500,000, and by at least the lesser of:
  - (a) 5% of the total of the \*adjustable values of \*primary interests in the \*losing entity owned by \*affected owners at:
    - (i) if subsection (4) applies—the time determined under that subsection; or
    - (ii) otherwise—the start of the income year in which the \*realisation event happens; and
  - (b) the amount worked out under the table.

**Alternative threshold for reduction of the total market value**

<b>Item</b>	<b>In this case:</b>	<b>The amount is:</b>
1	The ownership period is 4 years or less	worked out using this formula: $\$5,000,000 \times \frac{\text{Number of days in that period}}{365}$
2	The ownership period is more than 4 years	\$25,000,000

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 727-720**

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- (3A) If at the time referred to in subsection (3) a \*primary interest covered by that subsection was \*trading stock or a \*revenue asset, its \*adjustable value taken into account under that subsection is the greater of its adjustable value as a \*CGT asset and its adjustable value as trading stock or a revenue asset.
- (4) If the owner of the interest is an \*affected owner because of item 1, 2, 3 or 4 in the table in subsection 727-530(1) (about who is an affected owner), the time for the purposes of subparagraph (3)(a)(i) of this section is the latest of:
- (a) the start of the income year in which the \*realisation event happens; and
  - (b) the start of the most recent period (if any):
    - (i) that ended before or at the time of the \*realisation event; and
    - (ii) throughout which at least one of the group entities had the same \*ultimate controller as the losing entity or the gaining entity; and
  - (c) the start of the most recent period (if any):
    - (i) that ended before or at the time of the realisation event; and
    - (ii) within which at least one of the group entities has with the losing entity or with the gaining entity a \*common-ownership nexus.

**727-720 Abnormal service arrangement reduces value of losing entity that is *not* a group service provider by at least \$500,000**

- (1) It must be the case that at *no* time during the period when the owner owned the interest did the sole or dominant activity of the \*losing entity consist of providing services as mentioned in subsection 727-715(1).
- (2) It must be reasonable to conclude that the total (the ***total market value***) of the \*market values, immediately before the \*realisation event, of \*primary interests in the \*losing entity then owned by

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-720

\*affected owners is less than it would have been if none of the following had happened:

- (a) the \*95% services indirect value shift;
- (b) each \*predominantly-services indirect value shift that meets either of these conditions:
  - (i) its amount was less than \$500,000 and it happened within 4 years before the realisation event, or at the same time as the realisation event;
  - (ii) its amount was \$500,000 or more and it happened at any time before the realisation event, or at the same time as the realisation event;
 and that meets all of these conditions:
  - (iii) the same entity is the losing entity for it as for the 95% services indirect value shift;
  - (iv) it happened under a different \*scheme from the 95% services indirect value shift; and
  - (v) having regard to all relevant circumstances, it is reasonable to conclude that the sole or main reason why it happened under a different scheme was to prevent the conditions in section 727-705, 727-710, 727-715 or this section from being met.
- (3) It must also be reasonable to conclude that the total \*market value is less than it would have been by at least:
  - (a) \$500,000, if the total of the \*adjustable values, immediately before the \*realisation event, of the \*primary interests referred to in subsection (2) is less than or equal to \$10,000,000; or
  - (b) 5% of the total of those \*adjustable values, if that total is greater than \$10,000,000 and less than or equal to \$100,000,000; or
  - (c) \$5,000,000, if that total is greater than \$100,000,000.
- (4) The providing of the services mentioned in paragraph 727-700(2)(a) or (b) by the losing entity must *not* be in the ordinary course of its business.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-725

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**727-725 Meaning of *predominantly-services indirect value shift***

An \*indirect value shift is a *predominantly-services indirect value shift* if, and only if, the \*greater benefits consist entirely or predominantly of:

- (a) a right to have services that are covered by section 727-240 provided directly by the \*losing entity to the \*gaining entity; or
  - (b) services that are covered by section 727-240 and have been, are being, or are to be, so provided;
- or both.

**Subdivision 727-H—The adjustable value method**

**Guide to Subdivision 727-H**

**727-750 What this Subdivision is about**

Under the adjustable value method:

- the adjustable values of affected interests in the losing entity are reduced; and
- the adjustable values of affected interests in the gaining entity are uplifted, within limits worked out by references to the reductions in the adjustable values of affected interests in the losing entity.

The consequences of that are:

- the cost base and reduced cost base of the interests are reduced or uplifted (or both); and
- if the interests are also trading stock or revenue assets, there are further consequences for them in their character as such.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**727-755 Consequences of indirect value shift**

- (1) This Subdivision sets out the *adjustable value method* of working out the consequences (if any) of an \*indirect value shift.
- (2) If those consequences are to be worked out using that method:
  - (a) the \*adjustable value of each \*affected interest in the \*losing entity is reduced as provided in this Subdivision; and
  - (b) if the \*gaining entity is a company or trust (except one listed in section 727-125 (about superannuation entities)) immediately before the \*IVS time, the \*adjustable value of each \*affected interest in the \*gaining entity is uplifted as provided in this Subdivision.
- (3) The consequences for the \*affected interest depend on its character. There are consequences for the interest in its character as a \*CGT asset. However, if the interest is also \*trading stock or a \*revenue asset, there are additional consequences for it in that character.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-770

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## Reductions of adjustable value

### 727-770 Reduction under the adjustable value method

- (1) This section sets out how to work out the amount (if any) by which the \*adjustable value of an \*affected interest in the \*losing entity is reduced.
- (2) First, work out under section 727-775 whether the \*indirect value shift has produced for the owner of the interest a \*disaggregated attributable decrease in the \*market value of the interest.
- (3) If it has not, the interest's \*adjustable value is *not* reduced because of the \*indirect value shift.
- (4) If it has, the amount (if any) by which the interest's \*adjustable value is reduced is worked out on a \*loss-focussed basis under section 727-780.
- (5) However, if a choice is made in accordance with section 727-550 for the reduction *not* to be worked out on a \*loss-focussed basis, the reduction is equal to the \*disaggregated attributable decrease.

#### *Reduction not to exceed reasonable amount*

- (6) If the reduction worked out as provided in subsection (4) or (5) is not reasonable in the circumstances, having regard to the objects of this Division, the interest's \*adjustable value is instead reduced by so much of that reduction as is reasonable in the circumstances, having regard to those objects.

Note: The main object of this Division is set out in section 727-95.

### 727-775 Has there been a disaggregated attributable decrease?

- (1) This section sets out how to determine whether an \*indirect value shift has produced, for the owner of an \*equity or loan interest, a ***disaggregated attributable decrease*** in the \*market value of the interest and, if so, the amount of it.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-780

- (2) Work out the \*market value of the interest at the \*IVS time, but disregarding:
- (a) all effects on the market value of the interest during the \*IVS period, except effects that are reasonably attributable to the \*indirect value shift; and
  - (b) the effects (if any) of the indirect value shift on the market value of \*equity or loan interests, or \*indirect equity or loan interests, in the gaining entity.

(This result is called the *notional resulting market value*.)

Note: Paragraph (2)(b) is necessary because the market value of the interest may also have been affected by the increase in the market value of interests in the gaining entity, because the entity in which the interest is held had direct or indirect interests in both the losing entity and the gaining entity.

In such a case, the reduction in adjustable value under this Division will usually be offset by an uplift under this Division.

- (3) If the notional resulting \*market value is *less than* the market value (the *old market value*) of the interest:
- (a) at the start of the \*IVS period; or
  - (b) if the owner last began to own the interest during that period—when the owner last began to own the interest;
- the difference is the *disaggregated attributable decrease*.
- (4) The \*indirect value shift has *not* produced a disaggregated attributable decrease for the owner of the interest if the notional resulting \*market value is *greater than or equal to* the old market value.
- (5) The \*market value of the interest at a particular time may be worked out under subsection (2) or (3) by making a reasonable estimate of that market value.

### 727-780 Working out the reduction on a *loss-focussed basis*

- (1) Use the table in subsection (2) of this section to work out on a *loss-focussed basis* the amount (if any) by which the interest's \*adjustable value is reduced.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Chapter 3 Specialist liability rules

### Part 3-95 Value shifting

**Division 727** Indirect value shifting affecting interests in companies and trusts, and arising from non-arm's length dealings

#### Section 727-800

- (2) This involves comparing the old \*market value, and the notional resulting market value, with the interest's \*adjustable value (the *old adjustable value*) immediately before the \*IVS time.

Reduction under the attributable decrease method			
Item	If the old market value:	And the notional resulting market value:	This is the result:
1	is <i>greater than or equal to</i> the old adjustable value	is <i>less than</i> the old adjustable value	the *adjustable value is reduced to the notional resulting market value
2	is <i>greater than or equal to</i> the old adjustable value	is <i>greater than or equal to</i> the old adjustable value	the *adjustable value is <i>not</i> reduced because of the *indirect value shift
3	is <i>less than</i> the old adjustable value	is <i>less than</i> the old adjustable value	the *adjustable value is reduced by the amount of the *disaggregated attributable decrease

Note 1: Because of item 1, the indirect value shift cannot cause a loss to arise on disposal of the interest.

Note 2: Because of item 3 the loss already embedded in the interest is preserved, but the indirect value shift does not increase it.

### Uplifts of adjustable value

#### 727-800 Uplift under the attributable increase method

- (1) This section sets out how to work out the amount (if any) by which the \*adjustable value of an \*affected interest in the \*gaining entity is uplifted.
- (2) First, work out under section 727-805 whether the \*indirect value shift has produced for the owner of the interest a \*disaggregated attributable increase in the \*market value of the interest.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-800

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- (3) If it has not, the interest's \*adjustable value is *not* uplifted because of the \*indirect value shift.
- (4) If it has, the \*adjustable value is uplifted by the amount worked out using the scaling-down formula in section 727-810, subject to the rest of this section.

Note: The uplift will be less than or equal to the disaggregated attributable increase.

*Cap if interest has both a disaggregated attributable increase and a disaggregated attributable decrease*

- (5) If the \*indirect value shift has also produced for the owner of the interest a \*disaggregated attributable decrease in the \*market value of the interest, the interest's \*adjustable value:
  - (a) is *not* uplifted if it is not also reduced under this Division because of the indirect value shift; and
  - (b) if it is also reduced under this Division because of the indirect value shift—is not uplifted by more than the reduction.

*Cap based on notional distribution by gaining entity of dividends or capital equal to total reductions in adjustable value of affected interests in losing entity*

- (6) However, the interest's \*adjustable value is not uplifted by more than the greater of these amounts:
  - (a) the amount (if any) that the \*affected owner of the interest would receive (directly, or indirectly through one or more interposed entities) in respect of the interest if:
    - (i) the \*gaining entity were to pay as \*dividends, at the time (the **payment time**) immediately before the \*IVS time, an amount (the **total reduction amount**) equal to the total of the amounts by which the \*adjustable values of \*equity or loan interests in the \*losing entity are reduced under this Subdivision because of the \*indirect value shift; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Chapter 3** Specialist liability rules

**Part 3-95** Value shifting

**Division 727** Indirect value shifting affecting interests in companies and trusts, and arising from non-arm's length dealings

**Section 727-800**

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- (ii) those dividends were successively paid or distributed at the payment time by each entity interposed between the gaining entity and that affected owner; and
  - (b) the amount (if any) that the \*affected owner of the interest would receive (directly, or indirectly through one or more interposed entities) in respect of the interest if:
    - (i) the gaining entity were to pay the total reduction amount at the payment time as a distribution of capital; and
    - (ii) that capital was successively paid or distributed at the payment time by each entity interposed between the gaining entity and that affected owner.
- (6A) The reduction of \*adjustable value that is to be taken into account under subparagraph (6)(a)(i) for an \*equity or loan interest in the \*losing entity is:
- (a) if the interest is \*trading stock immediately before the \*IVS time—the one worked out on the basis of the interest's adjustable value under subsection 727-835(2); or
  - (b) otherwise—the greater or greatest of these:
    - (i) the reduction of the interest's \*cost base;
    - (ii) the reduction of the interest's \*reduced cost base;
    - (iii) the reduction (if any) worked out on the basis of the interest's adjustable value under subsection 727-840(2) (about revenue assets).

*Uplift not to exceed reasonable amount*

- (7) If the uplift worked out as provided in subsections (4), (5) and (6) is not reasonable in the circumstances, having regard to the objects of this Division, the interest's \*adjustable value is instead uplifted by an amount that is reasonable in the circumstances, having regard to those objects.

Note: The main object of this Division is set out in section 727-95.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**727-805 Has there been a disaggregated attributable increase?**

- (1) This section sets out how to determine whether an \*indirect value shift has produced, for the owner of an \*equity or loan interest, a ***disaggregated attributable increase*** in the \*market value of the interest and, if so, the amount of it.
- (2) Make a reasonable estimate of the \*market value of the interest at the \*IVS time, but disregarding:
  - (a) all effects on the market value of the interest during the \*IVS period, except effects that are reasonably attributable to the \*indirect value shift; and
  - (b) the effects (if any) of the indirect value shift on the market value of \*equity or loan interests, or \*indirect equity or loan interests, in the losing entity.

(This result is called the ***notional resulting market value***.)

Note: Paragraph (2)(b) is necessary because the market value of the interest may also have been affected by the decrease in the market value of interests in the losing entity, because the entity in which the interest is held had direct or indirect interests in both the losing entity and the gaining entity.

In such a case, the increase in adjustable value under this Division will usually be offset by a reduction under this Division.

- (3) If the notional resulting market value is *greater than* a reasonable estimate of the \*market value (the ***old market value***) of the interest:
  - (a) at the start of the \*IVS period; or
  - (b) if the owner last began to own the interest during that period—when the owner last began to own the interest;
 the difference is the ***disaggregated attributable increase***.
- (4) The \*indirect value shift has *not* produced a disaggregated attributable increase for the owner of the interest if the notional resulting market value is *less than or equal to* the old market value.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 727-810

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**727-810 Scaling-down formula**

- (1) The scaling-down formula for the purposes of section 727-800 is:

$$\frac{\text{The *disaggregated attributable increase}}{\text{Total reductions for affected interests}} \times \frac{\text{Total reductions for affected interests}}{\text{Total disaggregated attributable decreases}}$$

Note: The numerator in the fraction can never exceed the denominator. This means that the fraction can never exceed 1, so the uplift will never exceed the disaggregated attributable increase.

- (2) For the purposes of the formula:

***total disaggregated attributable decreases*** means the total of:

- (a) all \*disaggregated attributable decreases that the \*indirect value shift has produced, in the \*market values of \*affected interests in the \*losing entity, for the entities that owned those interests immediately before the \*IVS time; and
- (b) if:
  - (i) section 727-850 (as applying to the \*scheme from which the indirect value shift results) reduces losses that are \*realised for income tax purposes by \*realisation events happening before the \*IVS time to \*equity or loan interests, or to \*indirect equity or loan interests, in the losing entity; and
  - (ii) the indirect value shift is the only indirect value shift, or is the greater or greatest of 2 or more indirect value shifts, that results from the scheme and for which the losing entity is the losing entity;for each of those realisation events, the amounts that would, if:
  - (iii) the \*presumed indirect value shift were an indirect value shift; and
  - (iv) the IVS time for the presumed indirect value shift were the time of that realisation event;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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be the disaggregated attributable decreases that the presumed indirect value shift has produced, in the market value of the equity or loan interests to which that realisation event happened, for the entities that owned those interests immediately before the time of that realisation event.

***total reductions for affected interests*** means the total of:

- (a) all reductions under this Division, because of the indirect value shift, of \*adjustable values of affected interests in the losing entity; and
- (b) if paragraph (b) of the definition of ***total disaggregated attributable decreases*** applies—the amounts by which section 727-850 reduces the losses (if any) referred to in that paragraph.

## Consequences of the method for various kinds of assets

### 727-830 CGT assets

- (1) The \*cost base of an \*equity or loan interest is reduced or uplifted immediately before the \*IVS time to the extent that this Division provides for the \*adjustable value of the interest to be reduced or uplifted.
- (2) The \*reduced cost base of an \*equity or loan interest is reduced or uplifted immediately before the \*IVS time to the extent that this Division provides for the \*adjustable value of the interest to be reduced or uplifted.
- (3) However, the \*cost base or \*reduced cost base is *uplifted* only to the extent that the amount of the uplift is still reflected in the \*market value of the interest when a later \*CGT event happens to the interest.
- (4) To work out:
  - (a) whether the \*cost base or \*reduced cost base of the interest is reduced or uplifted; and
  - (b) if so, by how much;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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assume that the *adjustable value* from time to time of that or any other \*equity or loan interest is its cost base or reduced cost base, as appropriate.

- (5) If this Division provides for the \*adjustable value of an \*equity or loan interest to be *both* reduced and uplifted:
- (a) the reduction and uplift for which subsection (1) or (2) of this section provides offset each other to the extent of whichever of them is the lesser; but
  - (b) if subsection (3) of this section cancels or reduces the uplift, this subsection is taken always to have applied on that basis.

*Reductions and uplifts also apply to pre-CGT assets*

- (6) A reduction or uplift occurs regardless of whether the entity that owns the interest \*acquired it before, on or after 20 September 1985.

**727-835 Trading stock**

- (1) This section deals with:
- (a) how this Division applies to an \*equity or loan interest that is \*trading stock of an entity at the time (the *adjustment time*) immediately before the \*IVS time; and
  - (b) the income tax consequences of this Division reducing or uplifting the \*adjustable value of the interest.
- (2) The interest's *adjustable value* at a particular time is:
- (a) if the interest has been \*trading stock of the entity ever since the start of the income year of the entity in which that time occurs—its \*value as trading stock at the start of the income year; or
  - (b) otherwise—its cost.
- (3) If this Division reduces or uplifts the interest's \*adjustable value, the entity is treated as if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) immediately before the adjustment time, the entity had sold the interest to someone else (at \*arm's length and in the ordinary course of business) for its \*adjustable value immediately before that time; and
- (b) immediately after the adjustment time, the entity had bought the interest back for the reduced or uplifted adjustable value.

Note: The notional sale and repurchase are separated in time. As a result, if this section is applied to another indirect value shift that happens later in the same income year, the interest's adjustable value will be the cost on the notional repurchase: see paragraph (2)(b).

- (4) However, the increase in the cost of an interest because of paragraph (3)(b) is taken into account from time to time only to the extent that the amount of the increase is still reflected in the \*market value of the interest.

Note: The situations where the increase in cost would be taken into account include:

- in working out your deductions for the cost of trading stock acquired during the income year in which the increase happens; and
- the end of an income year if the interest's closing value as trading stock is worked out on the basis of its cost; and
- the start of the income year in which the interest is disposed of, if that happens in a later income year and the interest's closing value as trading stock at the end of the previous income year was worked out on the basis of its cost.

- (5) If this Division provides for the \*adjustable value of the interest to be *both* reduced and uplifted:
  - (a) the reduction and uplift offset each other to the extent of whichever of them is the lesser, and subsection (3) of this section applies accordingly; but
  - (b) to the extent that the amount of the uplift is no longer reflected in the \*market value of the interest, this section is taken always to have applied on the basis that the amount of the uplift was reduced to the same extent.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**727-840 Revenue assets**

- (1) This section deals with:
    - (a) how this Division applies to an \*equity or loan interest that is a \*revenue asset of an entity at the time (the *adjustment time*) immediately before the \*IVS time; and
    - (b) the income tax consequences of this Division reducing or uplifting the \*adjustable value of the interest.
  - (2) The interest's *adjustable value* at a particular time is the total of the amounts that would be subtracted from the gross disposal proceeds in calculating any profit or loss on disposal of the interest if the entity disposed of it at that time.
  - (3) If this Division reduces or uplifts the interest's \*adjustable value, the entity is treated as if:
    - (a) immediately before the adjustment time, the entity had sold the interest to someone else (at \*arm's length and in the ordinary course of business) for its adjustable value immediately before that time; and
    - (b) immediately after the adjustment time, the entity had bought the interest back for the reduced or uplifted adjustable value.
- Note: The notional sale and repurchase are separated in time. As a result, if this section is applied to another indirect value shift that happens later in the same income year, the interest's adjustable value will be based on the cost on the notional repurchase: see subsection (2).
- (4) However, an uplift in the \*adjustable value of the interest is taken into account only to the extent that the amount of the uplift is still reflected in the \*market value of the interest when it is disposed of or otherwise realised.
  - (5) If this Division provides for the \*adjustable value of the interest to be *both* reduced and uplifted:
    - (a) the reduction and uplift offset each other to the extent of whichever of them is the lesser, and subsection (3) of this section applies accordingly; but

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) to the extent that the amount of the uplift is no longer reflected in the \*market value of the interest, this section is taken always to have applied on the basis that the amount of the uplift was reduced to the same extent.

### **Subdivision 727-K—Reduction of loss on equity or loan interests realised before the IVS time**

#### **Table of sections**

727-850	Consequences of scheme under this Subdivision
727-855	Presumed indirect value shift
727-860	Conditions about the prospective gaining entity
727-865	How other provisions of this Division apply to support this Subdivision
727-870	Effect of CGT roll-over
727-875	Application to CGT asset that is also trading stock or revenue asset

#### **727-850 Consequences of scheme under this Subdivision**

- (1) If:
- (a) as at the time when a \*scheme is entered into, or a later time, an entity (the *prospective losing entity*) has \*provided, is providing, is to provide, or might provide, one or more economic benefits \*in connection with the scheme; and
  - (b) the prospective losing entity is a company or trust (except one listed in section 727-125 (about superannuation entities)); and
  - (c) a \*realisation event happens to an \*equity or loan interest, or to an \*indirect equity or loan interest, in the prospective losing entity at a time when no \*IVS time for the scheme has yet happened (whether or not one happens later); and
  - (d) apart from this Division, a loss would be \*realised for income tax purposes by the realisation event; and
  - (e) because of section 727-855, the scheme results in a \*presumed indirect value shift affecting the realisation event; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (f) section 727-860 (about prospective gaining entities) is satisfied; and
- (g) no exclusion in Subdivision 727-C applies to the presumed indirect value shift because of section 727-865; and
- (h) on the assumptions set out in subsection 727-865(3), the interest would be an \*affected interest in the prospective losing entity;

the loss is reduced by an amount that is reasonable having regard to a reasonable estimate of the amount (if any) by which the scheme has reduced the interest's \*market value during the period that ends at the time of the realisation event and started at the later of:

- (i) when the scheme was entered into; and
- (j) the time of the last realisation event that happened to the interest.

Note 1: This Subdivision does not reduce gains from realisation events, but loss reductions under this Subdivision are taken into account in working out:

- gain reductions under Subdivision 727-G for interests in a gaining entity that are realised after the IVS time for the scheme (see section 727-625); or
- uplifts under Subdivision 727-H in the adjustable values of interests in a gaining entity (see section 727-810).

Note 2: Section 727-865 provides for how other provisions of this Division apply for the purposes of this Subdivision.

*Further exclusion for certain 95% services indirect value shifts*

- (2) The loss is not reduced if the \*presumed indirect value shift is a \*95% services indirect value shift because of subsection 727-865(2), unless:
  - (a) the conditions in section 727-705 (as applying because of that subsection) are met for the presumed indirect value shift; or
  - (b) the conditions in section 727-710, 727-715 or 727-720 (as applying because of that subsection) are met for the presumed indirect value shift and for the realisation event.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**727-855 Presumed indirect value shift**

- (1) The \*scheme results in a ***presumed indirect value shift*** affecting the \*realisation event if, and only if, as at the time of the realisation event, it is reasonable to conclude that the total \*market value of the economic benefits (the ***greater benefits***) that:
  - (a) the \*prospective losing entity has \*provided, is providing, is to provide, or might provide, \*in connection with the \*scheme, to another entity, or to each of 2 or more other entities; and
  - (b) can be identified (even if the other entity or entities cannot be identified or are not all in existence, or the provision of some or all of the economic benefits is contingent);
 exceeds:
  - (c) the total market value of the economic benefits (the ***lesser benefits***) that:
    - (i) have been, are being, are to be, or might be, provided to the prospective losing entity in connection with the scheme; and
    - (ii) can be identified (even if the entity or entities providing the benefits cannot be identified or are not all in existence, or the provision of some or all of the economic benefits is contingent); or
  - (d) if there are no economic benefits covered by paragraph (c)—nil.
 That excess is the amount of the presumed indirect value shift, which happens at the time of the realisation event.
- (2) The \*market value of an economic benefit is to be determined as at the earliest time when it is reasonable to conclude that:
  - (a) the economic benefit can be identified; and
  - (b) paragraph 727-150(2)(b) is satisfied for that benefit;
 if that time is before the \*realisation event.
- (3) Otherwise, the \*market value of the economic benefit is to be determined as at the time immediately before the \*realisation event,

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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taking account of any contingency to which provision of the benefit is subject at that time.

For more rules affecting how the market value of an economic benefit is determined, see Subdivision 727-D (as applying because of subsection 727-865(1)).

- (4) An entity referred to in paragraph (1)(a) need not be a party to the \*scheme. A benefit can be provided by act or omission.

**727-860 Conditions about the prospective gaining entity**

- (1) By the deadline set out in subsection (5), the conditions in subsections (2) and (3) must be satisfied for at least one of these entities:
- (a) the entity or entities referred to in paragraph 727-855(1)(a);
  - (b) if at the time of the \*realisation event it is reasonable to conclude that the entity, or at least one of the entities, referred to in paragraph 727-855(1)(a) will be one of 2 or more entities, but it cannot be determined which—those 2 or more entities.
- (2) Enough must be known about the identity of an entity covered by subsection (1) for it to be reasonable to conclude that, if:
- (a) the \*presumed indirect value shift were an \*indirect value shift resulting from the \*scheme; and
  - (b) the \*IVS period for the scheme ended at the time of the \*realisation event; and
  - (c) that entity were the \*gaining entity for the indirect value shift;
  - (d) the \*prospective losing entity were the \*losing entity for the indirect value shift; and
- either or both of these would be satisfied for the indirect value shift:
- (e) section 727-105 (Ultimate controller test); and
  - (f) section 727-110 (Common-ownership nexus test).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (3) Enough must be known about the identity of the entity referred to in subsection (2) for it also to be reasonable to conclude that, in relation to either or both of the following:
  - (a) the \*prospective losing entity \*providing one or more economic benefits to that entity \*in connection with the \*scheme; or
  - (b) that entity providing one or more economic benefits to the prospective losing entity in connection with the scheme;
 that entity and the prospective losing entity were not, are not, will not be, or would not be, dealing with each other at \*arm's length.
- (4) Each entity that is covered by subsection (1), and for which subsections (2) and (3) are satisfied, is called a **prospective gaining entity** for the \*scheme.
- (5) The deadline is:
  - (a) if the entity that owned the \*equity or loan interest immediately before the \*realisation event must lodge an \*income tax return for the income year in which the event happens—the time by which the return must be lodged; or
  - (b) otherwise—the end of the 6 months immediately after that income year.

**727-865 How other provisions of this Division apply to support this Subdivision**

- (1) To avoid doubt, these provisions apply for the purposes of working out whether there has been a \*presumed indirect value shift and, if so, the amount of it:
  - (a) sections 727-155, 727-160 and 727-165 (about economic benefits);
  - (b) section 727-315 (Transfer, for its adjustable value, of depreciating asset acquired for less than \$1,500,000).
- (2) For the purposes of section 727-850, these provisions:
  - (a) Subdivision 727-C (Exclusions), except section 727-260 (about a shift down a wholly-owned chain of entities);

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) sections 727-700 to 727-725 (about 95% services indirect value shifts), except subsection 727-700(1);  
apply to the \*presumed indirect value shift on the assumptions set out in subsection (3).
- (3) The assumptions are:
- (a) the \*presumed indirect value shift is an \*indirect value shift resulting from the \*scheme; and
  - (b) the \*prospective losing entity for the scheme is the \*losing entity for that indirect value shift; and
  - (c) each \*prospective gaining entity for the scheme is the \*gaining entity for that indirect value shift; and
  - (d) the \*greater benefits under the presumed indirect value shift are the greater benefits under that indirect value shift; and
  - (e) the \*lesser benefits (if any) under the presumed indirect value shift are the lesser benefits under that indirect value shift; and
  - (f) the time of the realisation event mentioned in paragraph 727-850(1)(c) is the \*IVS time for the scheme; and
  - (g) the \*IVS period for the scheme ends at the time of the realisation event; and
  - (h) section 727-105 (Ultimate controller test) is satisfied for that indirect value shift according to what it is reasonable to conclude under subsection 727-860(2) as applying to the presumed indirect value shift; and
  - (i) section 727-110 (Common-ownership nexus test) is satisfied for that indirect value shift according to what it is reasonable to conclude under subsection 727-860(2) as applying to the presumed indirect value shift; and
  - (j) a reference to the realisation event mentioned in subsection 727-700(1) were a reference to the realisation event mentioned in paragraph 727-850(1)(c); and
  - (k) the interest to which the realisation event mentioned in paragraph 727-850(1)(c) happens were the interest referred to in paragraph 727-700(1)(a); and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (l) a reference in any of sections 727-700 to 727-725 (about 95% services indirect value shifts), except subsection 727-700(1), to the owner were a reference to the entity that, at the time of the realisation event mentioned in paragraph 727-850(1)(c), owns the interest to which the event happens.
- (4) Sections 727-635 and 727-640 affect how this Subdivision applies to \*equity or loan interests, and \*indirect equity or loan interests, in the \*prospective losing entity that are split or merged during the period:
  - (a) starting when the \*scheme is entered into; and
  - (b) ending at the time of the \*realisation event mentioned in paragraph 727-850(1)(c);in the same way as those sections affect how Subdivision 727-G would apply to those interests on the assumptions set out in subsection (3) of this section.
- (5) The application of a provision because of this section is additional to, and is not intended to limit, any other application of the provision.

**727-870 Effect of CGT roll-over**

- (1) If:
  - (a) the \*realisation event mentioned in paragraph 727-850(1)(c) is a \*CGT event; and
  - (b) section 727-850 reduces a loss that would, apart from this Division, be \*realised for income tax purposes by the CGT event; and
  - (c) there is a roll-over for the CGT event;the interest's \*reduced cost base at the time of the CGT event is taken to have been reduced by the amount by which section 727-850 reduces that loss, but is so taken only for the purposes of working out:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Chapter 3 Specialist liability rules

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- (d) the interest's reduced cost base, from time to time after the roll-over, for the entity that \*acquired the interest because of the CGT event; and
- (e) in the case of a \*replacement-asset roll-over—the reduced cost base of the replacement CGT asset, from time to time after the roll-over, for the entity that \*disposed of the interest.

Note: Because of the roll-over, the loss reduction under section 727-850 will have no tax effect. This subsection ensures that the loss reduction is passed on, through the reduction in reduced cost base, to prevent or reduce a loss arising on a later CGT event.

#### **727-875 Application to CGT asset that is also trading stock or revenue asset**

If an \*equity or loan interest is also an item of \*trading stock or a \*revenue asset, this Subdivision applies to the interest once in its character as a CGT asset and again in its character as trading stock or a revenue asset.

#### **Subdivision 727-L—Indirect value shift resulting from a direct value shift**

##### **Table of sections**

727-905	How this Subdivision affects the rest of this Division
727-910	Treatment of value shifted under the direct value shift

#### **727-905 How this Subdivision affects the rest of this Division**

- (1) This Subdivision affects how the rest of this Division applies to a \*scheme (the *IVS scheme*) that is or includes a scheme (the *DVS scheme*) under which there is a \*direct value shift.
- (2) If the \*direct value shift:
  - (a) has consequences under Division 725 for an entity as an \*affected owner of \*down interests (or would do so apart from section 725-90 (about direct value shifts that will be reversed)); and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) also has consequences under that Division for another entity as an affected owner of \*up interests (or would do so apart from section 725-90);

the rest of this Subdivision has effect, for the purposes of Subdivisions 727-A to 727-K, in order to determine:

- (c) whether the IVS scheme results in an \*indirect value shift, from the first entity to the other entity, that has consequences under this Division; and
- (d) whether the IVS scheme has consequences under Subdivision 727-K because it results in a \*presumed indirect value shift affecting a \*realisation event happening to \*equity or loan interests, or to \*indirect equity or loan interests, in the first entity; and
- (e) those consequences.

Note: Section 725-50 sets out when a direct value shift has consequences under Division 725.

- (3) If:

- (a) the IVS scheme is the DVS scheme; and
- (b) subsection 725-145(2) is satisfied for the \*direct value shift (because one or more equity or loan interests in the target entity are issued at a discount); but
- (c) subsection 725-145(3) (about an increase in the market value of one or more equity or loan interests in the target entity) is not satisfied for the direct value shift;

Subdivisions 727-A to 727-K apply to the IVS scheme only as provided in this section.

- (4) Otherwise, those Subdivisions apply to the IVS scheme as provided in this section in addition to any other application they have to the scheme.

**727-910 Treatment of value shifted under the direct value shift**

- (1) The first entity is treated as \*providing economic benefits to the other entity, \*in connection with the IVS scheme, at the time of a decrease (or future decrease) in the \*market value of any of the

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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\*down interests, to the extent that the decrease is (or will be) covered by subsection 725-155(1).

- (2) Despite subsections 727-150(4) and 727-855(2) and (3), the \*market value of all economic benefits that subsection (1) of this section treats the first entity as providing to the other entity:
- (a) is to be determined as at the time immediately before the \*IVS time, or immediately before the \*realisation event, as appropriate; and
  - (b) is equal to the total value shifted from the \*down interests to the \*up interests, as worked out under one or more applications of step 2 of the method statement in section 725-365 or 725-380.
- (3) The 2 entities are treated as not dealing with each other at \*arm's length in relation to the providing of those benefits.
- (4) None of those benefits is treated as consisting of, or including, services provided or a right to have services provided.
- Note: This means that the exclusions in Subdivisions 727-C and 727-G for indirect value shifts involving services will not apply.
- (5) Except as provided in this section, none of the following is treated as the \*providing of economic benefits \*in connection with the IVS scheme:
- (a) a decrease (or future decrease) in the \*market value of \*down interests owned by the first entity or the other entity, to the extent that the decrease is (or will be) covered by subsection 725-155(1);
  - (b) an increase (or future increase) in the market value of \*up interests owned by the first entity or the other entity, to the extent that the increase is (or will be) covered by subsection 725-145(3);
  - (c) an issue of \*up interests at a \*discount to the first entity or the other entity, to the extent that the issue is (or will be) covered by subsection 725-145(2).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Note: Value shifted from down interests owned by the other entity to up interests owned by the first entity are dealt with by a separate application of this Subdivision to those interests (because of paragraphs 727-905(2)(a) and (b)).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Chapter 4—International aspects of income tax**

### **Part 4-5—General**

#### **Division 764—Source rules**

##### **Table of Subdivisions**

Guide to Division 764

764-A Source rules

##### **Guide to Division 764**

##### **764-1 What this Division is about**

This Division contains a source rule for certain international tax agreements.

##### **Subdivision 764-A—Source rules**

##### **Table of sections**

764-5 Source rule for international tax agreements

##### **764-5 Source rule for international tax agreements**

- (1) For the purposes of this Act, income, profits or gains have a source in Australia if:
  - (a) for the purposes of an \*international tax agreement, the income, profits or gains are those of a person who is a resident of a foreign country or foreign territory; and
  - (b) the effect of the agreement is that the income, profits or gains may be taxed in Australia.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (2) Subsection (1) applies in relation to \*international tax agreements made on or after 28 March 2019.

Note: An international tax agreement not covered by this section may be subject to specific source rules contained in the *International Tax Agreements Act 1953* or in the international tax agreement itself.

- (3) This section has effect despite any other provision of this Act (other than Part IVA of the *Income Tax Assessment Act 1936*).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Division 768—Foreign non-assessable income and gains

### Table of Subdivisions

768-A	Returns on foreign investment
768-B	Some items of income that are exempt from income tax
768-G	Reduction in capital gains and losses arising from CGT events in relation to certain voting interests in active foreign companies
768-R	Temporary residents

### Subdivision 768-A—Returns on foreign investment

#### Guide to Subdivision 768-A

##### 768-1 What this Subdivision is about

If:

- (a) an Australian corporate tax entity receives a foreign equity distribution from a foreign company, either directly or indirectly through one or more interposed trusts or partnerships; and
- (b) the Australian corporate tax entity holds a participation interest of at least 10% in the foreign company;

the distribution is non-assessable non-exempt income for the Australian corporate tax entity.

### Table of sections

#### Foreign equity distributions on participation interests

768-5	Foreign equity distributions on participation interests
768-7	Foreign equity distributions entitled to a foreign income tax deduction
768-10	Meaning of <i>foreign equity distribution</i>
768-15	Participation test—minimum 10% participation

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Foreign equity distributions on participation interests

### 768-5 Foreign equity distributions on participation interests

#### *Foreign equity distributions received directly*

- (1) A \*foreign equity distribution is not assessable income, and is not \*exempt income, of the entity to which it is made if:
- (a) the entity is an Australian resident and a \*corporate tax entity; and
  - (b) at the time the distribution is made, the entity satisfies the participation test in section 768-15 in relation to the company that made the distribution; and
  - (c) the entity:
    - (i) does not receive the distribution in the capacity of a trustee; or
    - (ii) receives the distribution in the capacity of a trustee of a \*public trading trust; and
  - (d) the distribution is not one to which section 768-7 (which is about foreign income tax deductions) applies.

#### *Foreign equity distributions received through interposed trusts and partnerships*

- (2) An amount is not assessable income, and is not \*exempt income, of an entity if:
- (a) the entity is a beneficiary of a trust or a partner in a partnership, an Australian resident and a \*corporate tax entity; and
  - (b) the amount is all or part of the \*net income of the trust or partnership that would, apart from this subsection, be included in the entity's assessable income because of:
    - (i) Division 276; or
    - (ii) Division 5 or 6 of Part III of the *Income Tax Assessment Act 1936*; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (c) the amount can be attributed (either directly or indirectly through one or more interposed trusts or partnerships that are not \*corporate tax entities) to a \*foreign equity distribution; and
  - (d) at the time the distribution is made, the entity satisfies the participation test in section 768-15 in relation to the company that made the distribution; and
  - (e) the entity:
    - (i) does not receive the distribution in the capacity of a trustee; or
    - (ii) receives the distribution in the capacity of a trustee of a \*public trading trust; and
  - (f) the distribution is not one to which section 768-7 (which is about foreign income tax deductions) applies.
- (3) An amount that is \*non-assessable non-exempt income under subsection (2) is taken, for the purpose of section 25-90 (about deductions relating to foreign non-assessable non-exempt income) to be derived from the same source as the \*foreign equity distribution.

**768-7 Foreign equity distributions entitled to a foreign income tax deduction**

- (1) This section applies to a \*foreign equity distribution if:
- (a) all or part of the distribution gives rise to a \*foreign income tax deduction; and
  - (b) the exception in subsection (2) does not apply to the distribution.

*Exception for foreign corporate collective investment vehicles*

- (2) This subsection applies to a \*foreign equity distribution if:
- (a) the \*foreign income tax deduction arises because the company that made the distribution is recognised under the law of the foreign country in which the deduction arises as being used for collective investment; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (b) \*foreign income tax or a withholding-type tax was payable in respect of the distribution.

### **768-10 Meaning of *foreign equity distribution***

A ***foreign equity distribution*** is a \*distribution or \*non-share dividend made by a company that is not a Part X Australian resident (within the meaning of Part X of the *Income Tax Assessment Act 1936*) in respect of an \*equity interest in the company.

### **768-15 Participation test—minimum 10% participation**

An entity satisfies the participation test in this section in relation to another entity at a time if, at that time, the sum of the following is at least 10%:

- (a) the \*direct participation interest the entity would have in the other entity if rights on winding-up were disregarded;
- (b) the \*indirect participation interest the entity would have in the other entity if:
  - (i) rights on winding-up were disregarded; and
  - (ii) section 960-185 only applied to intermediate entities that are not \*corporate tax entities.

### **Subdivision 768-B—Some items of income that are exempt from income tax**

#### **Table of sections**

768-100	Foreign government officials in Australia
768-105	Compensation arising out of Second World War
768-110	Foreign residents deriving income from certain activities in Australia's exclusive economic zone or on or above Australia's continental shelf

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 768-100

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**768-100 Foreign government officials in Australia**

- (1) The amounts of \*ordinary income and \*statutory income covered by the table are exempt from income tax. In some cases, the exemption is subject to exceptions or special conditions, or both.

Note 1: Ordinary and statutory income that is exempt from income tax is called exempt income: see section 6-20. The note to subsection 6-15(2) describes some of the other consequences of it being exempt income.

Note 2: Even if an exempt payment is made to you, the Commissioner can still require you to lodge an income tax return or information under section 161 of the *Income Tax Assessment Act 1936*.

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<b>Exempt amounts</b>			
<b>Item</b>	<b>If you are:</b>	<b>the following amounts are exempt from income tax:</b>	<b>subject to these exceptions and special conditions:</b>
1	(a) a representative in Australia of the government of a foreign country; or (b) a member of the official staff of such a representative; and you are neither an Australian citizen nor ordinarily resident in Australia	(a) your official salary; and (b) your *ordinary income, and your *statutory income, from a source outside Australia	(a) no Convention listed in subsection (2) applies to the representative; and (b) the country concerned grants in relation to Australia exemptions from taxes on income that correspond with the exemption in this item

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Exempt amounts**

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Item	If you are:	the following amounts are exempt from income tax:	subject to these exceptions and special conditions:
2	(a) an officer of the government of a *Commonwealth of Nations country; and (b) temporarily in Australia to render service on behalf of that country, or an *Australian government agency, in accordance with an *arrangement between the governments of that country and of the Commonwealth or of a State or Territory	(a) your official salary; and (b) your *ordinary income, and your *statutory income, from a source outside Australia	that country exempts from income tax the salaries of officers of the government of the Commonwealth temporarily in that country for similar purposes in accordance with a similar arrangement

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(2) The Conventions are:

- (a) the Vienna Convention on Diplomatic Relations, as having the force of law because of the *Diplomatic Privileges and Immunities Act 1967*;
- (b) the Vienna Convention on Consular Relations, as having the force of law because of the *Consular Privileges and Immunities Act 1972*.

Note: Those Conventions have the force of law in Australia because of those Acts and achieve substantially the same effect as item 1 of the table: see Article 34 of the Vienna Convention on Diplomatic Relations and Article 49 of the Vienna Convention on Consular Relations.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 768-105

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**768-105 Compensation arising out of Second World War**

- (1) A payment to you is exempt from income tax if:
- (a) you are an Australian resident at the time when it would otherwise be included in your assessable income; and
  - (b) the payment is from a source in a foreign country; and
  - (c) the payment is in connection with:
    - (i) any wrong or injury; or
    - (ii) any loss of, or damage to, property; or
    - (iii) any other detriment;  
suffered by you or another individual as a result of:
    - (iv) persecution by the National Socialist regime of Germany during the National Socialist period; or
    - (v) persecution during the Second World War by any other enemy of the Commonwealth or by a regime covered by subsection (3); or
    - (vi) flight from persecution mentioned in subparagraph (iv) or (v); or
    - (vii) participation in a resistance movement during the Second World War against forces of the National Socialist regime of Germany or against forces of any other enemy of the Commonwealth; and
  - (d) the payment is not directly or indirectly from any of your  
\*associates.

Note: An example of a detriment covered by subparagraph (c)(iii) is if you lost the opportunity to qualify for a pension because your period of contribution was cut short because you had to flee persecution by the National Socialist regime.

*Duration of Second World War*

- (2) Subsection (1) applies to:
- (a) the period immediately before the Second World War; and
  - (b) the period immediately after the Second World War;
- in the same way as it applies to the period of the Second World War.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Regimes associated with an enemy of the Commonwealth*

- (3) This subsection covers a regime that was:
- (a) in alliance with; or
  - (b) occupied by; or
  - (c) effectively controlled by; or
  - (d) under duress from; or
  - (e) surrounded by;
- either or both of the following:
- (f) the National Socialist regime of Germany;
  - (g) any other enemy of the Commonwealth.

*Legal personal representative*

- (4) Subsection (1) applies to a payment to:
- (a) your \*legal personal representative; or
  - (b) a trust established by your will;
- in a corresponding way to the way in which it would have applied if:
- (c) the payment had been to you; and
  - (d) if the payment is made after your death—you were still alive.

**768-110 Foreign residents deriving income from certain activities in Australia's exclusive economic zone or on or above Australia's continental shelf**

- (1) The object of this section is to ensure Australia's compliance with certain provisions of the \*United Nations Convention on the Law of the Sea.

Note: The text of the United Nations Convention on the Law of the Sea is in Australian Treaty Series 1994 No. 31 ([1994] ATS 31) and could in 2014 be viewed in the Australian Treaties Library on the AustLII website (<http://www.austlii.edu.au>).

- (2) If you are a foreign resident, your \*ordinary income and \*statutory income is neither assessable income, nor \*exempt income, to the extent that:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 768-500

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- (a) the income is from an activity carried on in an area that is:
  - (i) part of Australia's exclusive economic zone; or
  - (ii) part of, or above, Australia's continental shelf; and
- (b) the activity is specified by regulation to be a prescribed activity for the purpose of this section.

**Subdivision 768-G—Reduction in capital gains and losses  
arising from CGT events in relation to certain voting  
interests in active foreign companies**

**Guide to Subdivision 768-G**

**768-500 What this Subdivision is about**

If:

- (a) a company has a capital gain or capital loss arising from a CGT event that happens in relation to a share in a foreign company; and
- (b) the company holds a direct voting percentage of 10% or more in the foreign company for a certain period before the CGT event happens;

the gain or loss is reduced by a percentage that reflects the degree to which the assets of the foreign company are used in an active business.

**Table of sections**

**Operative provisions**

768-505 Reducing a capital gain or loss from certain CGT events in relation to certain voting interests

**Active foreign business asset percentage**

768-510 Active foreign business asset percentage

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- 768-515 Choices to apply market value method or book value method
- 768-520 Market value method—choice made under subsection 768-515(1)
- 768-525 Book value method—choice made under subsection 768-515(2)
- 768-530 Active foreign business asset percentage—modifications for foreign life insurance companies and foreign general insurance companies
- 768-533 Foreign company that is a FIF using CFC calculation method—treatment as AFI subsidiary under this Subdivision
- 768-535 Modified rules for foreign wholly-owned groups

**Types of assets of a foreign company**

- 768-540 Active foreign business assets of a foreign company
- 768-545 Assets included in the total assets of a foreign company

**Voting percentages in a company**

- 768-550 Direct voting percentage in a company
- 768-555 Indirect voting percentage in a company
- 768-560 Total voting percentage in a company

**Operative provisions**

**768-505 Reducing a capital gain or loss from certain CGT events in relation to certain voting interests**

- (1) The *\*capital gain* or *\*capital loss* a company (the ***holding company***) that is an Australian resident makes from a *\*CGT event* that happened at a particular time (the ***time of the CGT event***) to a *\*share* in a company (the ***foreign disposal company***) that is a foreign resident is reduced if:
  - (a) the holding company held a *\*direct voting percentage* of 10% or more in the foreign disposal company throughout a 12 month period that:
    - (i) began no earlier than 24 months before the time of the CGT event; and
    - (ii) ended no later than that time; and
  - (b) the share is *not*:
    - (i) an eligible finance share (within the meaning of Part X of the *Income Tax Assessment Act 1936*); or

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*\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.*

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Section 768-510

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- (ii) a widely distributed finance share (within the meaning of that Part); and
  - (c) the CGT event is CGT event A1, B1, C2, E1, E2, G3, J1, K4, K6, K10 or K11.
- (2) The gain or loss is reduced by the \*active foreign business asset percentage (see sections 768-510, 768-530 and 768-535) of the foreign disposal company in relation to the holding company at the time of the CGT event.

**Active foreign business asset percentage**

**768-510 Active foreign business asset percentage**

- (1) The *active foreign business asset percentage* of a company (the *foreign company*) that is a foreign resident, in relation to the holding company mentioned in section 768-505, at the time of the CGT event mentioned in that section, is worked out in accordance with this section.

*Market value method*

- (2) Work out that percentage under section 768-520 if:
  - (a) the holding company has made a choice under subsection 768-515(1) in relation to the foreign company for that time; and
  - (b) there is sufficient evidence of the \*market value at that time of:
    - (i) all \*assets included in the total assets of the foreign company at that time; and
    - (ii) all \*active foreign business assets of the foreign company at that time.

*Book value method*

- (3) Work out that percentage under section 768-525 if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) the holding company has made a choice under subsection 768-515(2) in relation to the foreign company for that time; and
- (b) there are \*recognised company accounts of the foreign company for a period that ends no later than that time, but no more than 12 months before that time; and
- (c) if the foreign company was in existence before the start of the period mentioned in paragraph (b)—there are recognised company accounts of the foreign company for a period that ends at least 6 months, but no more than 18 months, before the end of the period mentioned in paragraph (b).

*Default method*

- (4) Otherwise, that percentage is:
  - (a) 100% (if this section is being applied for the purposes of section 768-505 to reduce a \*capital loss of the holding company); or
  - (b) zero (in any other case).

**768-515 Choices to apply market value method or book value method**

*Choice for market value method*

- (1) The holding company may choose to work out the \*active foreign business asset percentage of the foreign company for the time of the CGT event under section 768-520.

*Choice for book value method*

- (2) The holding company may choose to work out the \*active foreign business asset percentage of the foreign company for the time of the CGT event under section 768-525.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 768-520

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*Method of making choice*

- (3) The way an entity making a choice under subsection (1) or (2) prepares its \*income tax return is sufficient evidence of the making of the choice.

Note: If an entity does not make a choice under subsection (1) or (2), it will work out the active foreign business asset percentage of the foreign company in accordance with the default method in subsection 768-510(4).

**768-520 Market value method—choice made under subsection 768-515(1)**

- (1) The *active foreign business asset percentage* of the foreign company in relation to the holding company, at the time of the CGT event, is worked out under this section in this way.

*Method statement*

- Step 1. Work out the \*market value at that time of all \*assets included in the total assets of the foreign company at that time.
- Step 2. Work out the \*market value (see subsection (2)) at that time of all \*active foreign business assets of the foreign company at that time.
- Step 3. Divide the result of step 2 by the result of step 1.
- Step 4. Express the result of step 3 as a percentage, and round that percentage to the nearest whole percentage point (rounding a number ending in .5 upwards).
- Step 5. The *active foreign business asset percentage* is:
- (a) if the result of step 4 is less than 10%—zero; or
  - (b) if the result of step 4 is 10% or more, but less than 90%—that result; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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(c) if the result of step 4 is 90% or more—100%.

Note 1: If the foreign company is a foreign life insurance company or a foreign general insurance company, the result of step 2 is modified under section 768-530.

Note 2: If the foreign company is a member of a wholly-owned group, section 768-535 may modify the way in which this section operates.

(2) If, at the time of the CGT event:

(a) an \*active foreign business asset of the foreign company is a \*share in another company (the *subsidiary company*); and

(b) the subsidiary company is a foreign resident;

then, in working out the \*market value of all \*active foreign business assets of the foreign company at that time for the purposes of step 2 of the method statement in subsection (1), treat the \*market value of the share at that time according to the following table.

**Market value of a share in subsidiary company**

<b>Item</b>	<b>If:</b>	<b>treat the market value of the share as:</b>
1	(a) the foreign company has a *direct voting percentage of 10% or more in the subsidiary company at that time; and (b) the holding company has a *total voting percentage of 10% or more in the subsidiary company at that time	the *share's *market value at that time, multiplied by the *active foreign business asset percentage of the subsidiary company in relation to the holding company at that time
2	item 1 does not apply	zero

Note: For the purposes of item 1 of the table, it is necessary to work out the active foreign business asset percentage of the subsidiary company before working out the active foreign business asset percentage of the foreign company.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 768-525

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**768-525 Book value method—choice made under subsection 768-515(2)**

- (1) The *active foreign business asset percentage* of the foreign company in relation to the holding company, at the time of the CGT event, is worked out under this section in this way.

*Method statement*

- Step 1. Work out the foreign company's average value of total assets at that time under subsection (2).
- Step 2. Work out the foreign company's average value of active foreign business assets at that time under subsection (3).
- Step 3. Divide the result of step 2 by the result of step 1.
- Step 4. Express the result of step 3 as a percentage, and round that percentage to the nearest whole percentage point (rounding a number ending in .5 upwards).
- Step 5. The *active foreign business asset percentage* is:
- (a) if the result of step 4 is less than 10%—zero; or
  - (b) if the result of step 4 is 10% or more, but less than 90%—that result; or
  - (c) if the result of step 4 is 90% or more—100%.

Note: If the foreign company is a member of a wholly-owned group, section 768-535 may modify the way in which this section operates.

- (2) The foreign company's *average value of total assets* at the time of the CGT event is worked out in this way.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Method statement*

- Step 1. Work out the sum of the values (see subsection (5)) of every \*asset included in the total assets of the foreign company at the end of the most recent period:
- (a) that ends no later than that time, but no more than 12 months before that time; and
  - (b) for which the foreign company has \*recognised company accounts.
- Step 2. Work out the sum of the values (see subsection (5)) of every \*asset included in the total assets of the foreign company at the end of the most recent period:
- (a) that ends at least 6 months, but no more than 18 months, before the end of the period mentioned in step 1; and
  - (b) for which the foreign company has \*recognised company accounts.
- Note: See subsection (6) if the foreign company does not have recognised company accounts for a period mentioned in this step.
- Step 3. Work out the sum of the results of steps 1 and 2, and divide that sum by 2.

- (3) The foreign company's ***average value of active foreign business assets*** at that time is worked out in this way.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 768-525

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*Method statement*

- Step 1. Work out the sum of the values (see subsections (4) and (5)) of every \*active foreign business asset of the foreign company at the end of the most recent period:
- (a) that ends no later than that time, but no more than 12 months before that time; and
  - (b) for which the foreign company has \*recognised company accounts.
- Step 2. Work out the sum of the values (see subsections (4) and (5)) of every \*active foreign business asset of the foreign company at the end of the most recent period:
- (a) that ends at least 6 months, but no more than 18 months, before the end of the period mentioned in step 1; and
  - (b) for which the foreign company has \*recognised company accounts.
- Note: See subsection (6) if the foreign company does not have recognised company accounts for a period mentioned in this step.
- Step 3. Work out the sum of the results of steps 1 and 2, and divide that sum by 2.

Note: If the foreign company is a foreign life insurance company or a foreign general insurance company, the results of steps 1 and 2 are modified under section 768-530.

- (4) If an \*active foreign business asset of the foreign company is a \*share in another company (the ***subsidiary company***) that is a foreign resident, then, for the purposes of steps 1 and 2 of the method statement in subsection (3), treat the value of the share at a particular time according to the following table.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Value of a share in subsidiary company**

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Item	If:	treat the value of the share as:
1	(a) the foreign company has a *direct voting percentage of 10% or more in the subsidiary company at that time; and (b) the holding company has a *total voting percentage of 10% or more in the subsidiary company at that time	the *share's value (see subsection (5)) at that time, multiplied by the *active foreign business asset percentage of the subsidiary company in relation to the holding company at that time
2	item 1 does not apply	zero

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Note: For the purposes of item 1 of the table, it is necessary to work out the active foreign business asset percentage of the subsidiary company before working out the active foreign business asset percentage of the foreign company.

- (5) For the purposes of this section, the value of an asset of a foreign company at the end of a period is taken to be:
- (a) the value of the asset as shown in the \*recognised company accounts of the foreign company for that period; or
  - (b) if the value of the asset is *not* shown in the recognised company accounts of the foreign company for that period—zero.
- (6) The result of:
- (a) step 2 of the method statement in subsection (2); and
  - (b) step 2 of the method statement in subsection (3);
- is taken to be zero if the foreign company does not have \*recognised company accounts for a period mentioned in those steps.

Note: This will only be the case if the foreign company was not in existence before the start of the period mentioned in step 1 of those method statements (see paragraph 768-510(3)(c)).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 768-530

**768-530 Active foreign business asset percentage—modifications for foreign life insurance companies and foreign general insurance companies**

- (1) If the foreign company is a \*foreign life insurance company or a \*foreign general insurance company, work out its \*active foreign business asset percentage according to section 768-510, but with the modifications set out in subsections (2) and (3).
- (2) Treat a reference in the following provisions to a period as a reference to a \*statutory accounting period of the foreign company:
  - (a) paragraphs 768-510(3)(b) and (c);
  - (b) section 768-525.
- (3) Apply the modifications set out in the following table.

<b>Modifications for foreign life insurance companies and foreign general insurance companies</b>		
<b>Item</b>	<b>The result of this step:</b>	<b>is increased by the amount applicable under subsection (4) for this statutory accounting period:</b>
1	step 2 of the method statement in subsection 768-520(1)	the most recent *statutory accounting period of the foreign company ending at or before the time mentioned in that step
2	step 1 of the method statement in subsection 768-525(3)	the *statutory accounting period mentioned in that step (as modified by subsection (2) of this section)
3	step 2 of the method statement in subsection 768-525(3)	the *statutory accounting period mentioned in that step (as modified by subsection (2) of this section)

- (4) The amount applicable under this subsection for a \*statutory accounting period of the foreign company is worked out using the following formula:

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

$$\text{Value of non-active foreign business assets} \times \frac{\text{Active insurance amount}}{\text{Total insurance assets}}$$

where:

**active insurance amount means:**

- (a) if the foreign company is a \*foreign life insurance company—the untainted policy liabilities (within the meaning of subsection 446(2) of the *Income Tax Assessment Act 1936*) of the foreign company for the statutory accounting period; or
- (b) if the foreign company is a \*foreign general insurance company—the active general insurance amount worked out under subsection (5) for the statutory accounting period.

**total insurance assets means:**

- (a) if the foreign company is a \*foreign life insurance company—the total assets (within the meaning of subsection 446(2) of the *Income Tax Assessment Act 1936*) of the foreign company for the statutory accounting period; or
- (b) if the foreign company is a \*foreign general insurance company—the total assets (within the meaning of subsection 446(4) of that Act) of the foreign company for the statutory accounting period.

**value of non-active foreign business assets means:**

- (a) for the purposes of item 1 of the table in subsection (3)—the difference between:
  - (i) the result of step 1 of the method statement in subsection 768-520(1); and
  - (ii) the result of step 2 of that method statement (apart from this section); or
- (b) for the purposes of item 2 of the table in subsection (3)—the difference between:
  - (i) the result of step 1 of the method statement in subsection 768-525(2); and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) the result of step 1 of the method statement in subsection 768-525(3) (apart from this section); or
- (c) for the purposes of item 3 of the table in subsection (3)—the difference between:
  - (i) the result of step 2 of the method statement in subsection 768-525(2); and
  - (ii) the result of step 2 of the method statement in subsection 768-525(3) (apart from this section).

*Active insurance amount for foreign general insurance company*

- (5) The active general insurance amount under this subsection for a \*statutory accounting period of the foreign company is worked out using the following formula:

$$\text{Total general insurance assets} - \text{Net assets} - \text{Tainted outstanding claims} + \text{Solvency amount}$$

where:

**net assets** means the net assets (within the meaning of subsection 446(4) of the *Income Tax Assessment Act 1936*) of the foreign company for the statutory accounting period.

**solvency amount** means the solvency amount (within the meaning of subsection 446(4) of the *Income Tax Assessment Act 1936*) of the foreign company for the statutory accounting period.

**tainted outstanding claims** means the tainted outstanding claims (within the meaning of subsection 446(4) of the *Income Tax Assessment Act 1936*) of the foreign company for the statutory accounting period.

**total general insurance assets** means the total assets (within the meaning of subsection 446(4) of the *Income Tax Assessment Act 1936*) of the foreign company for the statutory accounting period.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**768-533 Foreign company that is a FIF using CFC calculation method—treatment as AFI subsidiary under this Subdivision**

- (1) This section applies if:
- (a) the foreign company is a FIF (within the meaning of former section 481 of the *Income Tax Assessment Act 1936*); and
  - (b) the holding company has made a choice under former subsection 559A(1) of the *Income Tax Assessment Act 1936* in relation to the foreign company in respect of a notional accounting period (within the meaning of former section 486 of that Act) of the foreign company that ends in the 2009-10 income year; and
  - (c) because of the choice, the foreign company has been treated under former paragraph 559A(3)(c) of that Act as an AFI subsidiary (within the meaning of that Act) in relation to that holding company; and
  - (d) the holding company makes a choice under subsection (1A) in relation to the foreign company; and
  - (e) the holding company has not failed to make a choice under that subsection for the 2010-11 income year or any later income year.
- (1A) A holding company may make a choice under this subsection in relation to a foreign company if the holding company could have made a choice in relation to the foreign company under former section 559A of the *Income Tax Assessment Act 1936* if it had not been repealed by item 37 of Schedule 1 to the *Tax Laws Amendment (Foreign Source Income Deferral) Act (No. 1) 2010*.
- (2) For the purposes of this Subdivision, treat the foreign company as an AFI subsidiary in relation to that holding company at that time.

**768-535 Modified rules for foreign wholly-owned groups**

- (1) This section applies if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 768-535

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- (a) for the purposes of section 768-505, it is necessary to work out the \*active foreign business asset percentage of a company (the **top foreign company**) in relation to the holding company mentioned in that section, at the time of the CGT event mentioned in that section; and
  - (b) the top foreign company is *not*:
    - (i) an AFI subsidiary (within the meaning of Part X of the *Income Tax Assessment Act 1936*); or
    - (ii) a \*foreign life insurance company; or
    - (iii) a \*foreign general insurance company; and
  - (c) for the purposes of section 768-505, it is also necessary (apart from this section) to work out the active foreign business asset percentage at that time of 1 or more other companies in relation to the holding company, at that time, where:
    - (i) the top foreign company and 1 or more of those other companies (the **subsidiary foreign companies**) are members of a \*wholly-owned group; and
    - (ii) each of the subsidiary foreign companies is a \*100% subsidiary of the top foreign company.
- (2) The holding company may choose to work out the \*active foreign business asset percentage of the top foreign company in accordance with subsections (4) and (6).
- (3) The way an entity making a choice under subsection (2) prepares its \*income tax return is sufficient evidence of the making of the choice.
- (4) If the holding company has made a choice under subsection (2), the provisions mentioned in subsection (5) operate, for the purposes of section 768-505, as if each subsidiary foreign company were a part of the top foreign company, rather than a separate entity.

Note 1: This subsection means that certain assets are not treated as active foreign business assets, or as assets included in the total assets, of any of the subsidiary foreign companies or of the top foreign company. For example:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) a share owned by one of those companies in another of those companies; and
- (b) a debt owed by one of those companies to another of those companies.

Note 2: If an asset (other than an asset mentioned in Note 1) is actually an active foreign business asset, or an asset included in the total assets, of a subsidiary foreign company, it is treated under this subsection as an active foreign business asset, or as an asset included in the total assets, of the top foreign company.

- (5) For the purposes of subsection (4), the provisions are:
  - (a) section 768-540 (active foreign business assets of a foreign company); and
  - (b) section 768-545 (assets included in the total assets of a foreign company).
- (6) If the holding company has made a choice under subsection (2), then for the purposes of sections 768-510 and 768-525, treat the \*recognised consolidated accounts of the top foreign company and all of the subsidiary foreign companies as the \*recognised company accounts of the top foreign company.

## Types of assets of a foreign company

### 768-540 Active foreign business assets of a foreign company

- (1) An asset is, at a particular time, an **active foreign business asset** of a company (the **foreign company**) that is a foreign resident if, at that time:
  - (a) the asset is an \*asset included in the total assets of the company; and
  - (b) the asset satisfies any of these conditions:
    - (i) the asset is used, or held ready for use, by the company in the course of carrying on a \*business;
    - (ii) the asset is goodwill;
    - (iii) the asset is a \*share; and
  - (c) the asset is *not* any of the following:
    - (i) \*taxable Australian property;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) a \*membership interest in a company that is an Australian resident;
    - (iii) a membership interest in a \*resident trust for CGT purposes;
    - (iv) an option or right to acquire a membership interest mentioned in subparagraph (ii) or (iii); and
  - (d) the asset is *not* covered by subsection (2); and
  - (e) if the foreign company is an AFI subsidiary (within the meaning of Part X of the *Income Tax Assessment Act 1936*) whose sole or principal business is financial intermediary business—the asset is *not* covered under subsection (4).
- (2) An asset is covered by this subsection if it is:
- (a) a financial instrument (other than a \*share or a trade debt); or
  - (b) either:
    - (i) an eligible finance share (within the meaning of Part X of the *Income Tax Assessment Act 1936*); or
    - (ii) a widely distributed finance share (within the meaning of that Part); or
  - (c) an interest in a trust or \*partnership; or
  - (d) a \*life insurance policy; or
  - (e) a right or option in respect of:
    - (i) a financial instrument; or
    - (ii) an interest in a company, trust or partnership; or
    - (iii) a life insurance policy; or
  - (f) cash or cash equivalent; or
  - (g) an asset whose main use in the course of carrying on the \*business mentioned in subparagraph (1)(b)(i) is to \*derive interest, an \*annuity, rent, \*royalties or foreign exchange gains unless:
    - (i) the asset is an intangible asset and has been substantially developed, altered or improved by the foreign company so that its \*market value has been substantially enhanced; or
    - (ii) its main use for deriving rent was only temporary.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (3) If, at the time mentioned in subsection (1), the foreign company is an AFI subsidiary (within the meaning of Part X of the *Income Tax Assessment Act 1936*) whose sole or principal business is financial intermediary business (within the meaning of that Part), subsection (2) operates as if:
- (a) paragraphs (2)(a) and (f) were omitted; and
  - (b) paragraph (2)(g) did not contain a reference to interest, an \*annuity or foreign exchange gains; and
  - (c) subparagraph (2)(e)(i) were omitted and the following subparagraph were substituted:
    - (i) a financial instrument, other than an asset mentioned in paragraph 450(1)(b) of the *Income Tax Assessment Act 1936*; or
- (4) The asset is covered under this subsection if:
- (a) all of these conditions are satisfied:
    - (i) the asset is an asset mentioned in subparagraph 450(4)(b)(i) or (ii) of the *Income Tax Assessment Act 1936*;
    - (ii) the asset was acquired from another entity;
    - (iii) either of the conditions mentioned in subparagraph 450(6)(c)(i) and (ii) of the *Income Tax Assessment Act 1936* were satisfied in relation to the other entity at the time of the acquisition; or
  - (b) both of these conditions are satisfied:
    - (i) the asset relates to a debt to which factoring income (within the meaning of Part X of the *Income Tax Assessment Act 1936*) of the foreign company relates;
    - (ii) the condition in paragraph 450(8)(b) of the *Income Tax Assessment Act 1936* is satisfied in relation to the debt.

#### **768-545 Assets included in the total assets of a foreign company**

- (1) At a particular time, an asset is an ***asset included in the total assets*** of a company (the ***foreign company***) that is a foreign resident if:
- (a) the asset is a \*CGT asset at that time; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the foreign company owns the asset at that time; and
  - (c) if at that time the foreign company is *not* an AFI subsidiary (within the meaning of Part X of the *Income Tax Assessment Act 1936*) whose sole or principal business is financial intermediary business (within the meaning of that Part)—the asset is *not* a foreign company derivative asset covered by subsection (2).
- (2) An asset is a foreign company derivative asset covered by this subsection if:
  - (a) the asset is an \*arrangement covered by subsection (3), unless the regulations declare the asset *not* to be a foreign company derivative asset covered by this subsection; or
  - (b) the regulations declare the asset to be a foreign company derivative asset covered by this subsection.
- (3) An \*arrangement is covered by this subsection if:
  - (a) under the arrangement, a party to the arrangement must, or may be required to, provide at some future time consideration of a particular kind or kinds to someone; and
  - (b) that future time is not less than the number of days, prescribed by regulations made for the purposes of paragraph 761D(1)(b) of the *Corporations Act 2001*, after the day on which the arrangement is entered into; and
  - (c) the amount of the consideration, or the value of the arrangement, is ultimately determined, \*derived from or varies by reference to (wholly or in part) the value or amount of something else (of any nature whatsoever and whether or not deliverable), including, for example, one or more of the following:
    - (i) an asset;
    - (ii) a rate (including an interest rate or exchange rate);
    - (iii) an index;
    - (iv) a commodity; and
  - (d) subsection (4) does not apply in relation to the arrangement.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (4) An \*arrangement under which one person has an obligation to buy, and another person has an obligation to sell, property is not an arrangement covered by subsection (3) merely because the arrangement provides for the consideration to be varied by reference to a general inflation index such as the Consumer Price Index.

## Voting percentages in a company

### 768-550 Direct voting percentage in a company

- (1) An entity's **direct voting percentage** at a particular time in a company is:
- (a) if the entity has a voting interest (within the meaning of section 334A of the *Income Tax Assessment Act 1936*) in the foreign company at that time amounting to a percentage of the voting power of the company—that percentage; or
  - (b) otherwise—zero.
- (2) In applying section 334A of the *Income Tax Assessment Act 1936* for the purposes of subsection (1) of this section, assume that:
- (a) the entity is a company; and
  - (b) the entity is not the beneficial owner of a \*share in the company if a trust or partnership is interposed between the entity and the company.

### 768-555 Indirect voting percentage in a company

- (1) An entity's **indirect voting percentage** at a particular time in a company (the **subsidiary company**) is worked out by multiplying:
- (a) the entity's \*direct voting percentage (if any) in another company (the **intermediate company**) at that time;
- by:
- (b) the sum of:
    - (i) the intermediate company's direct voting percentage (if any) in the subsidiary company at that time; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) the intermediate company's indirect voting percentage (if any) in the subsidiary company at that time (as worked out under one or more other applications of this section).
- (2) If there is more than one intermediate company to which subsection (1) applies at that time, the entity's ***indirect voting percentage*** is the sum of the percentages worked out under subsection (1) in relation to each of those intermediate companies.

**768-560 Total voting percentage in a company**

An entity's ***total voting percentage*** at a particular time in a company is the sum of:

- (a) the entity's \*direct voting percentage in the company at that time; and
- (b) the entity's \*indirect voting percentage in the company at that time.

**Subdivision 768-R—Temporary residents**

**Guide to Subdivision 768-R**

**768-900 What this Subdivision is about**

This Subdivision modifies the general tax rules for people in Australia who are temporary residents, whether Australian residents or foreign residents.

Generally foreign income derived by temporary residents is non-assessable non-exempt income and capital gains and losses they make are also disregarded for CGT purposes. There are some exceptions for employment-related income and capital gains on shares and rights acquired under employee share schemes.

Temporary residents are also partly relieved of record-keeping obligations in relation to the controlled foreign company rules.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Interest paid by temporary residents is not subject to withholding tax and may be non-assessable non-exempt income for a foreign resident.

## Table of sections

### Operative provisions

768-905	Objects
768-910	Income derived by temporary resident
768-915	Certain capital gains and capital losses of temporary resident to be disregarded
768-950	Individual becoming an Australian resident
768-955	Temporary resident who ceases to be temporary resident but remains an Australian resident
768-960	Temporary resident not attributable taxpayer for purposes of controlled foreign companies rules
768-970	Modification of rules for accruals system of taxation of certain non-resident trust estates
768-980	Interest paid by temporary resident

## Operative provisions

### 768-905 Objects

The objects of this Subdivision are to:

- (a) provide \*temporary residents with tax relief on most foreign source income and capital gains; and
- (b) relieve the burdens associated with complying with certain record-keeping obligations and interest withholding tax obligations.

### 768-910 Income derived by temporary resident

- (1) The following are \*non-assessable non-exempt income:
  - (a) the \*ordinary income you \*derive directly or indirectly from a source other than an \*Australian source if you are a \*temporary resident when you derive it;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) your \*statutory income (other than a \*net capital gain) from a source other than an Australian source if you are a temporary resident when you derive it.

This subsection has effect subject to subsections (3) and (5).

Note: A capital gain or loss you make may be disregarded under section 768-915.

- (2) For the purposes of paragraph (1)(b):
  - (a) if you have statutory income because a particular circumstance occurs, you derive the statutory income at the time when the circumstance occurs; and
  - (b) if you have statutory income because a number of circumstances occur, you derive the statutory income at the time when the last of those circumstances occurs.

*Exception to subsection (1)*

- (3) However, the following are not \*non-assessable non-exempt income under subsection (1):
  - (a) the \*ordinary income you \*derive directly or indirectly from a source other than an \*Australian source to the extent that it is remuneration, for employment undertaken, or services provided, while you are a \*temporary resident;
  - (b) your \*statutory income (other than a \*net capital gain) from a source other than an Australian source to the extent that it relates to employment undertaken, or services provided, while you are a temporary resident;
  - (c) an amount included in your assessable income under Division 86.

Note: This subsection only makes an amount not non-assessable non-exempt income under subsection (1). It does not prevent that amount from being non-assessable non-exempt income under some other provision of this Act or the *Income Tax Assessment Act 1936*.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**768-915 Certain capital gains and capital losses of temporary resident to be disregarded**

- (1) A \*capital gain or \*capital loss you make from a \*CGT event is disregarded if:
  - (a) you are a \*temporary resident when, or immediately before, the CGT event happens; and
  - (b) you would not make a capital gain or loss from the CGT event, or the capital gain or loss from the CGT event would have been disregarded under Division 855, if you were a foreign resident when, or immediately before, the CGT event happens.
- (2) Subsection (1) does not apply in relation to \*CGT event I1 if:
  - (a) the CGT event happens in relation to an \*ESS interest that is a beneficial interest in a right (or to a \*share acquired by exercising such a right); and
  - (b) the provisions referred to in paragraphs 83A-33(1)(a) to (c) (about start ups) apply to the ESS interest.

**768-950 Individual becoming an Australian resident**

Section 855-45 does not apply to your becoming an Australian resident if you are a \*temporary resident immediately after you become an Australian resident.

**768-955 Temporary resident who ceases to be temporary resident but remains an Australian resident**

- (1) If you are a \*temporary resident and you then cease to be a temporary resident (but remain, at that time, an Australian resident), there are rules relevant to each \*CGT asset that:
  - (a) you owned just before you ceased to be a temporary resident; and
  - (b) is not \*taxable Australian property; and
  - (c) you \*acquired on or after 20 September 1985.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (2) The first element of the \*cost base and \*reduced cost base of the asset (at the time you cease to be a \*temporary resident) is its \*market value at that time.
- (3) Also, Parts 3-1 and 3-3 apply to the asset as if you had \*acquired it at the time you ceased to be a \*temporary resident.
- (4) This section does not apply to an \*ESS interest if:
  - (a) Subdivision 83A-C (about employee share schemes) applies to the interest, and the \*ESS deferred taxing point for the interest has not yet occurred; or
  - (b) the provisions referred to in paragraphs 83A-33(1)(a) to (c) (about start ups) apply to the ESS interest.

**768-960 Temporary resident not attributable taxpayer for purposes of controlled foreign companies rules**

For the purposes of Part X of the *Income Tax Assessment Act 1936* (which deals with the attribution of income in respect of controlled foreign companies), you are taken not to be an \*attributable taxpayer in relation to a \*CFC or \*CFT at any time you are a \*temporary resident.

**768-970 Modification of rules for accruals system of taxation of certain non-resident trust estates**

At any time when you are a \*temporary resident, you are taken not to be a resident for the purposes of section 102AAZD of the *Income Tax Assessment Act 1936*.

**768-980 Interest paid by temporary resident**

Interest that is paid by a \*temporary resident:

- (a) is an amount to which section 128B (liability to withholding tax) of the *Income Tax Assessment Act 1936* does not apply; and
- (b) is \*non-assessable non-exempt income if the interest is:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



- (i) \*derived by a foreign resident; and
- (ii) is not derived from carrying on \*business in Australia at or through a \*permanent establishment in Australia.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Division 770—Foreign income tax offsets**

### **Table of Subdivisions**

#### Guide to Division 770

- 770-A Entitlement rules for foreign income tax offsets
- 770-B Amount of foreign income tax offset
- 770-C Rules about payment of foreign income tax
- 770-D Administration

### **Guide to Division 770**

#### **770-1 What this Division is about**

You may get a non-refundable tax offset for foreign income tax paid on your assessable income.

There is a limit on the amount of the tax offset.

A resident of a foreign country does not get the offset for some foreign income taxes.

You may also get the offset for foreign income tax paid on some amounts that are not taxed in Australia.

#### **770-5 Object**

- (1) The object of this Division is to relieve double taxation where:
  - (a) you have paid foreign income tax on amounts included in your assessable income; and
  - (b) you would, apart from this Division, pay Australian income tax on the same amounts.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (2) To achieve this object, this Division gives you a tax offset to reduce or eliminate Australian income tax otherwise payable on those amounts.

Note 1: This Division applies in relation to Medicare levy and Medicare levy (fringe benefits) surcharge in the same way as it applies to Australian income tax. See section 90-1 in Schedule 1 to the *Taxation Administration Act 1953*.

Note 2: The tax offset under this Division can be applied against your Medicare levy and Medicare levy (fringe benefits) surcharge liability for the year, if an amount of it remains after you apply it against your basic income tax liability. See item 22 of the table in subsection 63-10(1).

### **Subdivision 770-A—Entitlement rules for foreign income tax offsets**

#### **Table of sections**

##### **Basic entitlement rule for foreign income tax offset**

770-10 Entitlement to foreign income tax offset

770-15 Meaning of *foreign income tax*, *credit absorption tax* and *unitary tax*

#### **Basic entitlement rule for foreign income tax offset**

##### **770-10 Entitlement to foreign income tax offset**

- (1) You are entitled to a \*tax offset for an income year for \*foreign income tax. An amount of foreign income tax counts towards the tax offset for the year if you paid it in respect of an amount that is all or part of an amount included in your assessable income for the year.

Note 1: The offset is for the income year in which your assessable income included an amount in respect of which you paid foreign income tax—even if you paid the foreign income tax in another income year.

Note 2: If the foreign income tax has been paid on an amount that is part non-assessable non-exempt income and part assessable income for you for the income year, only a proportionate share of the foreign income tax (the share that corresponds to the part that is assessable

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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income) will count towards the tax offset (excluding the operation of subsection (2)).

*Taxes paid on section 23AI or 23AK amounts*

- (2) An amount of \*foreign income tax counts towards the \*tax offset for you for the year if you paid it in respect of an amount that is your \*non-assessable non-exempt income under either section 23AI or 23AK of the *Income Tax Assessment Act 1936* for the year.

Note 1: Sections 23AI and 23AK of the *Income Tax Assessment Act 1936* provide that amounts paid out of income previously attributed from a controlled foreign company or a foreign investment fund are non-assessable non-exempt income.

Note 2: Foreign income taxes covered by this subsection are direct taxes (for example, a withholding tax on a dividend payment) and not underlying taxes, only some of which are covered by section 770-135.

*Exception for certain residence-based foreign income taxes*

- (3) An amount of \*foreign income tax you paid does not count towards the \*tax offset for the year if you paid it:
- (a) to a foreign country because you are a resident of that country for the purposes of a law relating to the foreign income tax; and
  - (b) in respect of an amount derived from a source outside that country.

*Exception for previously complying funds and previously foreign funds*

- (4) An amount of \*foreign income tax paid by a \*superannuation provider in relation to a \*superannuation fund does not count towards the \*tax offset for the year if:
- (a) the tax was paid in respect of an amount included in the fund's assessable income under table item 2 or 3 in section 295-320; and
  - (b) the provider paid the tax before the start of the income year.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Note: Table items 2 and 3 in section 295-320 include additional amounts in the assessable income of superannuation funds that change their status from complying to non-complying or from foreign to Australian.

*Exception for credit absorption tax and unitary tax*

- (5) An amount of \*credit absorption tax or \*unitary tax you paid does not count towards the \*tax offset for the year.

**770-15 Meaning of *foreign income tax*, *credit absorption tax* and *unitary tax***

- (1) ***Foreign income tax*** means tax that:
- (a) is imposed by a law other than an \*Australian law; and
  - (b) is:
    - (i) tax on income; or
    - (ii) tax on profits or gains, whether of an income or capital nature; or
    - (iii) any other tax, being a tax that is subject to an agreement having the force of law under the *International Tax Agreements Act 1953*.

Note: Foreign income tax includes only that which has been correctly imposed in accordance with the relevant foreign law or, where the foreign jurisdiction has a tax treaty with Australia (having the force of law under the *International Tax Agreements Act 1953*), has been correctly imposed in accordance with that tax treaty.

- (2) ***Credit absorption tax*** means a tax imposed by a law of a foreign country, or of any part of, or place in, a foreign country to the extent that the tax would not have been payable if the entity concerned or another entity had not been entitled to an offset in respect of the tax under this Division.
- (3) ***Unitary tax*** means a tax imposed by a law of a foreign country, or of any part of, or place in, a foreign country, being a law which, for the purposes of taxing income, profits or gains of a company derived from sources within that country, takes into account, or is entitled to take into account, income, losses, outgoings or assets of the company (or of a company that for the purposes of that law is

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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treated as being associated with the company) derived, incurred or situated outside that country, but does not include tax imposed by that law if that law only takes those matters into account:

- (a) if such an associated company is a resident of the foreign country for the purposes of the law of the foreign country; or
- (b) for the purposes of granting any form of relief in relation to tax imposed on dividends received by one company from another company.

**Subdivision 770-B—Amount of foreign income tax offset**

**Guide to Subdivision 770-B**

**770-65 What this Subdivision is about**

The amount of your tax offset is based on the amount of foreign income tax you have paid.

However, there is a limit on the maximum amount of your offset. The limit is the greater of \$1,000 and an amount worked out under this Subdivision. This amount is based on a comparison between your tax liability and the tax liability you would have if certain foreign-taxed and foreign-sourced income and related deductions were disregarded.

You may choose to use the limit of \$1,000 and not work out this amount.

There is an increase in the limit to ensure foreign income tax paid on some amounts that are not taxed always forms part of the offset.

**Table of sections**

**Operative provisions**

770-70	Amount of foreign income tax offset
770-75	Foreign income tax offset limit

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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770-80 Increase in offset limit for tax paid on amounts to which section 23AI or 23AK of the *Income Tax Assessment Act 1936* apply

## Operative provisions

### 770-70 Amount of foreign income tax offset

The amount of your \*tax offset for the year is the sum of the \*foreign income tax you paid that counts towards the offset for the year.

Note 1: The amount of foreign income tax you paid may be affected by Subdivision 770-C.

Note 2: The amount of the offset might be increased under section 770-230 of the *Income Tax (Transitional Provisions) Act 1997*, if you have pre-commencement excess foreign income tax.

### 770-75 Foreign income tax offset limit

- (1) There is a limit (the **offset limit**) on the amount of your \*tax offset for a year. If your tax offset exceeds the offset limit, reduce the offset by the amount of the excess.
- (2) Your offset limit is the greater of:
  - (a) \$1,000; and
  - (b) this amount:
    - (i) the amount of income tax payable by you for the income year; *less*
    - (ii) the amount of income tax that would be payable by you for the income year if the assumptions in subsection (4) were made.

Note 1: If you do not intend to claim a foreign income tax offset of more than \$1,000 for the year, you do not need to work out the amount under paragraph (b).

Note 2: The amount of the offset limit might be increased under section 770-80.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 770-80

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- (3) For the purposes of paragraph (2)(b), work out the amount of income tax payable by you, or that would be payable by you, disregarding any \*tax offsets.
- (4) Assume that:
- (a) your assessable income did not include:
    - (i) so much of any amount included in your assessable income as represents an amount in respect of which you paid \*foreign income tax that counts towards the \*tax offset for the year; and
    - (ii) any other amounts of \*ordinary income or \*statutory income from a source other than an \*Australian source; and
  - (b) you were not entitled to any deductions that:
    - (i) are \*debt deductions that are attributable to an \*overseas permanent establishment of yours; or
    - (ii) are deductions (other than debt deductions) that are reasonably related to amounts covered by paragraph (a) for that year.

Note: You must also assume you were not entitled to any deductions for certain converted foreign losses: see section 770-35 of the *Income Tax (Transitional Provisions) Act 1997*.

Example: If an entity has paid foreign income tax on a capital gain that comprises part of its net capital gain, only that capital gain on which foreign income tax has been paid is disregarded.

**770-80 Increase in offset limit for tax paid on amounts to which section 23AI or 23AK of the *Income Tax Assessment Act 1936* apply**

Your offset limit under subsection 770-75(2) is increased by any amounts of \*foreign income tax that count towards the \*tax offset for you for the year because of subsection 770-10(2).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Subdivision 770-C—Rules about payment of foreign income tax****Table of sections****Rules about when foreign tax is paid**

770-130 When foreign income tax is considered paid—taxes paid by someone else

770-135 Foreign income tax paid by CFCs on attributed amounts

**Rules about when foreign tax is considered not paid**

770-140 When foreign income tax is considered not paid—anti-avoidance rule

**Rules about when foreign tax is paid****770-130 When foreign income tax is considered paid—taxes paid by someone else**

- (1) This Act applies to you as if you had paid an amount of \*foreign income tax in respect of an amount (a ***taxed amount***) that is all or part of an amount included in your \*ordinary income or \*statutory income if you are covered by subsection (2) or (3) for an amount of foreign income tax paid in respect of the taxed amount.
- (2) You are covered by this subsection for an amount of \*foreign income tax paid in respect of a taxed amount if that foreign income tax has been paid in respect of the taxed amount by another entity under an \*arrangement with you or under the law relating to the foreign income tax.  
  
Example: You are a partner in a partnership and the partnership pays foreign income tax on the partnership income.
- (3) You are covered by this subsection for an amount of \*foreign income tax paid in respect of the taxed amount to the extent that:
  - (a) the taxed amount is taken, because of section 6B of the *Income Tax Assessment Act 1936* (the ***1936 Act***), to be attributable to another amount of income of a particular kind or source; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) foreign income tax has been paid in respect of the other amount of income; and
- (c) the taxed amount is less than it would have been if that tax had not been paid.

**Example:** Aust Co (an Australian resident) is the sole beneficiary of an Australian resident trust H and is presently entitled to all the income of trust H. Trust H owns shares in For Co (a foreign company). For Co pays a dividend to trust H and the dividend is subject to withholding tax in For Co's country of residence.

Trust H allocates to Aust Co, the dividend, as well as other Australian source income trust H earned in the year (none of which was subject to foreign income tax). Aust Co is treated as having paid the foreign income tax paid by For Co under subsection 770-130(3). The foreign income tax is treated as paid in respect of the amount included in Aust Co's assessable income that is attributable to the dividend.

**770-135 Foreign income tax paid by CFCs on attributed amounts**

- (1) This Division applies to an entity (other than a \*CFC) as if it had paid an amount of \*foreign income tax worked out under subsection (7) in respect of an amount included in its assessable income if:
  - (a) the amount is included in its assessable income as described in subsection (2); and
  - (b) the conditions in subsections (3) and (5) are satisfied.
- (2) An amount is included in an entity's assessable income as described in this subsection if the entity is a company and the amount is included under:
  - (a) section 456 (a **section 456 case**) of the 1936 Act in relation to a \*CFC and a statutory accounting period; or
  - (b) section 457 (a **section 457 case**) of that Act in relation to a CFC.

**Note:** Section 456 of the 1936 Act includes, in the assessable income of certain Australian shareholders, amounts that are attributable to the profits of an Australian-controlled foreign company.

Section 457 does likewise when a controlled foreign company changes residence from an unlisted to a listed country or to Australia.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

*Tax paid condition*

- (3) An amount of \*foreign income tax, income tax or \*withholding tax (the **tax amount**) must have been paid:
- (a) for a section 456 case—by the \*CFC in respect of an amount included in the notional assessable income of the CFC for the statutory accounting period; or
  - (b) for a section 457 case—by the CFC.

Note: Section 770-130 deems foreign income tax to have been paid in certain circumstances.

- (4) For the purposes of paragraphs (3)(a) and (b), the tax amount includes an amount that is taken to have been paid by the \*CFC under subsection 393(4) of the 1936 Act (about tax paid on reinsurance premiums).

*Association condition*

- (5) If the entity is a company, it must have an \*attribution percentage of 10% or more:
- (a) for a section 456 case—in relation to the \*CFC at the end of the statutory accounting period; or
  - (b) for a section 457 case—in relation to the CFC at the residence-change time (within the meaning of section 457 of the 1936 Act).

*Amount of foreign income tax*

- (7) The amount worked out under this subsection is:
- (a) for a section 456 case—the sum of all the tax amounts for the statutory accounting period multiplied by the company's \*attribution percentage in relation to the \*CFC at the time mentioned in paragraph (5)(a); or
  - (b) for a section 457 case—the sum of all the tax amounts to the extent they are attributable to the amount included in the company's assessable income under section 457 of the 1936 Act.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 770-140

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*Grossing-up of attributed amount*

- (8) For the purposes of this Act except this section and section 371 of the 1936 Act (for a section 456 case or a section 457 case), the amount included in the entity's assessable income as described in subsection (2) is taken to be increased by the amount of tax worked out under subsection (7).

Note: Section 371 of the 1936 Act records an amount in an attribution account when the amount is included in the assessable income of an attributable taxpayer in relation to a CFC.

**Rules about when foreign tax is considered not paid**

**770-140 When foreign income tax is considered not paid—  
anti-avoidance rule**

Despite anything else in this Division, this Act applies to you as if you had *not* paid an amount of \*foreign income tax to the extent that you or any other entity become entitled to:

- (a) a refund of the foreign income tax; or
- (b) any other benefit worked out by reference to the amount of the foreign income tax (other than a reduction in the amount of the foreign income tax).

**Subdivision 770-D—Administration**

**Table of sections**

770-190 Amendment of assessments

**770-190 Amendment of assessments**

- (1) Section 170 of the *Income Tax Assessment Act 1936* does not prevent the amendment of an assessment for the purpose of giving effect to this Division for an income year if:
- (a) an event described in subsection (2) (an ***amendment event***) happens after the time you lodged your \*income tax return for that year; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (b) the amendment is made at any time during the period of 4 years starting immediately after the amendment event.

Note: Section 170 of that Act specifies the periods within which assessments may be amended.

(2) The following are amendment events:

- (a) you pay an amount of \*foreign income tax that counts towards your \*tax offset for the year;
- (b) there is an increase in an amount of foreign income tax you paid that counts towards your offset for the year;
- (c) there is a reduction in an amount of foreign income tax you paid that counts towards your offset for the year.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Division 775—Foreign currency gains and losses**

### **Table of Subdivisions**

#### Guide to Division 775

- 775-A Objects of this Division
- 775-B Realisation of forex gains or losses
- 775-C Roll-over relief for facility agreements
- 775-D Qualifying forex accounts that pass the limited balance test
- 775-E Retranslation for qualifying forex accounts
- 775-F Retranslation under foreign exchange retranslation election under Subdivision 230-D

### **Guide to Division 775**

#### **775-5 What this Division is about**

Your assessable income includes a forex realisation gain you make as a result of a forex realisation event.

You can deduct a forex realisation loss that you make as a result of a forex realisation event.

There are 5 main types of forex realisation events:

- (a) forex realisation event 1 happens if you dispose of foreign currency, or a right to receive foreign currency, to another entity;
- (b) forex realisation event 2 happens if you cease to have a right to receive foreign currency (otherwise than because you disposed of the right to another entity);

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (c) forex realisation event 3 happens if you cease to have an obligation to receive foreign currency;
- (d) forex realisation event 4 happens if you cease to have an obligation to pay foreign currency;
- (e) forex realisation event 5 happens if you cease to have a right to pay foreign currency.

There are special rules for certain short-term forex realisation gains and losses.

You may choose roll-over relief for certain facility agreements.

You may elect to receive concessional tax treatment for a qualifying forex account that passes the limited balance test.

You may choose retranslation for a qualifying forex account.

## Subdivision 775-A—Objects of this Division

### Table of sections

775-10 Objects of this Division

### 775-10 Objects of this Division

The objects of this Division are as follows:

- (a) to recognise \*foreign currency gains and losses for income tax purposes;
- (b) to quantify those gains and losses by reference to the change in the Australian dollar value of rights and obligations;
- (c) to treat certain foreign currency denominated financing facilities that are the economic equivalent of a loan as if the relevant facility were a loan;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 775-10**

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- (d) to reduce compliance costs by not requiring the recognition of certain low-value foreign currency gains and losses that involve substantial calculations.

**Subdivision 775-B—Realisation of forex gains or losses**

**Table of sections**

775-15	Forex realisation gains are assessable
775-20	Certain forex realisation gains are exempt income
775-25	Certain forex realisation gains are non-assessable non-exempt income
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775-70	Tax consequences of certain short-term forex realisation gains
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775-85	Forex cost base of a right to receive foreign currency
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775-95	Proceeds of assuming an obligation to pay foreign currency
775-100	Net costs of assuming an obligation to receive foreign currency
775-105	Currency exchange rate effect
775-110	Constructive receipts and payments
775-115	Economic set-off to be treated as legal set-off
775-120	Non-arm's length transactions
775-125	CGT consequences of the acquisition of foreign currency as a result of forex realisation event 2 or 3
775-130	Certain deductions not allowable
775-135	Right to receive or pay foreign currency
775-140	Obligation to pay or receive foreign currency

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- 775-145 Application of forex realisation events to currency and fungible rights and obligations
- 775-150 Transitional election
- 775-155 Applicable commencement date
- 775-160 Exception—event happens before the applicable commencement date
- 775-165 Exception—currency or right acquired, or obligation incurred, before the applicable commencement date
- 775-168 Exception—disposal or redemption of traditional securities
- 775-175 Application to things happening before commencement

## **775-15 Forex realisation gains are assessable**

### *Basic rule*

- (1) Your assessable income for an income year includes a \*forex realisation gain you make as a result of a \*forex realisation event that happens during that year.

### *Exceptions*

- (2) However, your assessable income does not include a \*forex realisation gain to the extent that it:
  - (a) is a gain of a private or domestic nature; and
  - (b) is not covered by an item of the table:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-15

<b>Forex realisation gains to which this subsection does not apply</b>			
<b>Item</b>	<b>You make the forex realisation gain as a result of this event...</b>	<b>happening to...</b>	<b>and the following condition is satisfied...</b>
1	forex realisation event 1 or 2	*foreign currency or a right, or a part of a right, to receive foreign currency	a gain that would result from the occurrence of a *realisation event in relation to the foreign currency, or to the right, or the part of the right, would, apart from this Division, be taken into account under Part 3-1 or 3-3
2	forex realisation event 2	a right, or a part of a right, created or acquired in return for the occurrence of a *realisation event in relation to a *CGT asset you own, where subparagraph 775-45(1)(b)(iv) applies	a gain or loss that would result from the occurrence of the realisation event in relation to the CGT asset would be taken into account for the purposes of Part 3-1 or 3-3
3	forex realisation event 4	an obligation, or a part of an obligation, you incurred in return for the acquisition of a *CGT asset	a gain or loss that would result from the occurrence of a *realisation event in relation to the CGT asset would be taken into account for the purposes of Part 3-1 or 3-3

Note: Parts 3-1 and 3-3 deal with capital gains and losses.

(3) Section 775-70 provides for additional exceptions.

Note: Section 775-70 is about the tax consequences of certain short-term forex realisation gains.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

*No double taxation*

- (4) To the extent that a \*forex realisation gain would be included in your assessable income under this section and another provision of this Act, the gain is only included in your assessable income under this section.

Note: Under section 230-20, foreign exchange gains from a Division 230 financial arrangement are dealt with under Division 230 and not under this Division.

**775-20 Certain forex realisation gains are exempt income**

A \*forex realisation gain you make is \*exempt income to the extent that, if it had been a \*forex realisation loss, it would have been made in gaining or producing exempt income.

**775-25 Certain forex realisation gains are non-assessable non-exempt income**

A \*forex realisation gain you make is \*non-assessable non-exempt income to the extent that, if it had been a \*forex realisation loss, it would have been made in gaining or producing non-assessable non-exempt income.

**775-27 Certain forex realisation gains are non-assessable non-exempt income**

Sections 775-20 and 775-25 apply to a \*forex realisation gain only if, had it been a \*forex realisation loss, it would have been disregarded under section 775-35.

**775-30 Forex realisation losses are deductible**

*Basic rule*

- (1) You can deduct from your assessable income for an income year a \*forex realisation loss that you make as a result of a \*forex realisation event that happens during that year.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 775-30**

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*Exceptions*

- (2) However, you cannot deduct a \*forex realisation loss under this section to the extent that it:
- (a) is a loss of a private or domestic nature; and
  - (b) is not covered by an item of the table:

<b>Forex realisation losses to which this subsection does not apply</b>			
<b>Item</b>	<b>You make the forex realisation loss as a result of this event...</b>	<b>happening to...</b>	<b>and the following condition is satisfied...</b>
1	forex realisation event 2	a right, or a part of a right, created or acquired in return for the occurrence of a *realisation event in relation to a *CGT asset you own, where subparagraph 775-45(1)(b) (iv) applies	a gain or loss that would result from the occurrence of the realisation event in relation to the CGT asset would be taken into account for the purposes of Part 3-1 or 3-3
2	forex realisation event 4	an obligation, or a part of an obligation, you incurred in return for the acquisition of a *CGT asset	a gain or loss that would result from the occurrence of a *realisation event in relation to the CGT asset would be taken into account for the purposes of Part 3-1 or 3-3

Note: Parts 3-1 and 3-3 deal with capital gains and losses.

- (3) Section 775-75 provides for additional exceptions.

Note: Section 775-75 is about the tax consequences of certain short-term forex realisation losses.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*No double deductions*

- (4) To the extent that this section and another provision of this Act would allow you a deduction for a \*forex realisation loss, you can only deduct the loss under this section.

Note: Under section 230-20, foreign exchange losses from a Division 230 financial arrangement are dealt with under Division 230 and not under this Division.

**775-35 Certain forex realisation losses are disregarded**

- (1) A \*forex realisation loss you make as a result of forex realisation event 1, 2 or 5 is disregarded to the extent that it is made in gaining or producing \*exempt income or \*non-assessable non-exempt income.
- (2) A \*forex realisation loss you make as a result of forex realisation event 3, 4 or 6 is disregarded to the extent that:
- (a) it is made in gaining or producing \*exempt income or \*non-assessable non-exempt income; and
  - (b) the obligation, or the part of the obligation, does not give rise to a deduction.

**775-40 Disposal of foreign currency or right to receive foreign currency—forex realisation event 1**

*Forex realisation event 1*

- (1) **Forex realisation event 1** is \*CGT event A1 that happens if you dispose of:
- (a) \*foreign currency; or
  - (b) a right, or a part of a right, to receive foreign currency.

Note: For extended meaning of **right to receive foreign currency**, see section 775-135.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 775-40**

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*Disposal*

- (2) For the purposes of this section, use subsection 104-10(2) to work out whether you have disposed of:
- (a) \*foreign currency; or
  - (b) a right, or a part of a right, to receive foreign currency.

Note: Under subsection 104-10(2), a disposal requires a change of ownership.

*Time of event*

- (3) For the purposes of this section, subsection 104-10(3) is modified so that the time of the event is when:
- (a) the \*foreign currency is disposed of; or
  - (b) the right, or the part of the right, is disposed of.

*Forex realisation gain*

- (4) You make a **forex realisation gain** if:
- (a) you make a \*capital gain from the event; and
  - (b) some or all of the capital gain is attributable to a \*currency exchange rate effect.

The amount of the **forex realisation gain** is so much of the capital gain as is attributable to a currency exchange rate effect.

Note: For **currency exchange rate effect**, see section 775-105.

- (5) For the purposes of paragraph (4)(a), Part 3-1 is modified so that section 118-20 is disregarded in working out the \*capital gain.

Note: Section 118-20 deals with reducing capital gains if an amount is otherwise assessable.

*Forex realisation loss*

- (6) You make a **forex realisation loss** if:
- (a) you make a \*capital loss from the event; and
  - (b) some or all of the capital loss is attributable to a \*currency exchange rate effect.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-45

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The amount of the *forex realisation loss* is so much of the capital loss as is attributable to a currency exchange rate effect.

Note: For *currency exchange rate effect*, see section 775-105.

*No indexation of cost base*

- (7) For the purposes of this section, disregard Division 114.

Note: Division 114 deals with indexation of the cost base.

*Foreign currency hedging gains and losses*

- (8) For the purposes of this section, disregard section 118-55.

Note: Section 118-55 deals with foreign currency hedging gains and losses.

*Capital proceeds*

- (9) For the purposes of this section, if the \*capital proceeds from the event are more or less than the \*market value of:
- (a) the \*foreign currency; or
  - (b) the right, or the part of the right;
- the capital proceeds from the event are taken to be the market value. (The market value is worked out as at the time of the event.)

**775-45 Ceasing to have a right to receive foreign currency—forex realisation event 2**

*Forex realisation event 2*

- (1) **Forex realisation event 2** happens if:
- (a) you cease to have a right, or a part of a right, to receive \*foreign currency; and
  - (b) the right, or the part of the right, is one of the following:
    - (i) a right, or a part of a right, to receive, or that represents, \*ordinary income or \*statutory income (other than statutory income that is assessable under this Division or Division 102);

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-45

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- (ii) a right, or a part of a right, created or acquired in return for your ceasing to \*hold a \*depreciating asset;
- (iii) a right, or a part of a right, created or acquired in return for your paying, or agreeing to pay, an amount of Australian currency or foreign currency;
- (iv) a right, or a part of a right, created or acquired in return for the occurrence of a \*realisation event in relation to a \*CGT asset you own, and none of subparagraphs (i), (ii) and (iii) applies; and
- (c) you did not cease to have the right, or the part of the right, because you disposed of the right or the part of the right (within the meaning of section 775-40).

Note 1: Disposals are dealt with by section 775-40 (forex realisation event 1).

Note 2: For extended meaning of *right to receive foreign currency*, see section 775-135.

*Time of event*

- (2) The time of the event is when you cease to have the right or the part of the right.

*Forex realisation gain*

- (3) You make a **forex realisation gain** if:
  - (a) the amount you receive in respect of the event happening exceeds the \*forex cost base of the right or the part of the right (the forex cost base is worked out as at the tax recognition time); and
  - (b) some or all of the excess is attributable to a \*currency exchange rate effect.

The amount of the **forex realisation gain** is so much of the excess as is attributable to a currency exchange rate effect.

Note 1: For *forex cost base*, see section 775-85.

Note 2: For *tax recognition time*, see subsection (7).

Note 3: For *currency exchange rate effect*, see section 775-105.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



*Forex realisation loss*

- (4) You make a **forex realisation loss** if:
- (a) the amount you receive in respect of the event happening falls short of the \*forex cost base of the right or the part of the right (the forex cost base is worked out as at the tax recognition time); and
  - (b) some or all of the shortfall is attributable to a \*currency exchange rate effect.

The amount of the **forex realisation loss** is so much of the shortfall as is attributable to a currency exchange rate effect.

Note 1: For **forex cost base**, see section 775-85.

Note 2: For **tax recognition time**, see subsection (7).

Note 3: For **currency exchange rate effect**, see section 775-105.

- (5) You make a **forex realisation loss** if:
- (a) the event happens because an option to buy \*foreign currency expires without having been exercised, or is cancelled, released or abandoned; and
  - (b) you were capable of exercising the option immediately before the event happened.

The amount of the **forex realisation loss** is the amount you paid in return for the grant or acquisition of the option.

*Non-cash benefit*

- (6) The amount you receive in respect of the event happening can include a \*non-cash benefit. Use the \*market value of the benefit to work out the amount you receive.

*Tax recognition time*

- (7) For the purposes of this section, the **tax recognition time** is worked out using the table:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-45

<b>Tax recognition time</b>		
<b>Item</b>	<b>If the right, or part of the right, is...</b>	<b>the <i>tax recognition time</i> is...</b>
1	a right, or a part of a right, to receive, or that represents, *ordinary income or *statutory income (other than statutory income that is assessable under this Division or Division 102)	(a) in the case of ordinary income—when the ordinary income is *derived; or (b) in the case of statutory income—when the requirement first arose to include the statutory income in your assessable income.
2	a right, or a part of a right, created or acquired in return for your ceasing to *hold a *depreciating asset	when you stop holding the asset.
3	a right, or a part of a right, referred to in subsection 775-165(3) (which deals with extensions of loans)	the extension time referred to in that subsection.
4	a right, or a part of a right, created or acquired in return for your paying, or agreeing to pay, an amount of Australian currency, where item 3 does not apply	when the amount is paid.
5	a right, or a part of a right, created or acquired in return for your paying, or agreeing to pay, an amount of *foreign currency, where item 3 does not apply	when the amount is paid.
6	a right, or a part of a right, created in return for the occurrence of a *realisation event in relation to a *CGT asset you own, and none of the above items apply	when the realisation event occurs.

Note: Subsection 775-260(1) modifies the tax recognition time if forex realisation event 2 happens in relation to a qualifying forex account that has ceased to pass the limited balance test.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**775-50 Ceasing to have an obligation to receive foreign currency—  
forex realisation event 3**

*Forex realisation event 3*

(1) **Forex realisation event 3** happens if:

- (a) you cease to have an obligation, or a part of an obligation, to receive \*foreign currency; and
- (b) the obligation, or the part of the obligation, is one of the following:
  - (i) an obligation, or a part of the obligation, incurred in return for the creation or acquisition of a right to pay foreign currency;
  - (ii) an obligation, or a part of the obligation, incurred in return for the creation or acquisition of a right to pay Australian currency;
  - (iii) an obligation, or a part of an obligation, under an option to sell foreign currency.

Note 1: For extended meaning of **obligation to receive foreign currency**, see section 775-140.

Note 2: For extended meaning of **right to pay foreign currency**, see section 775-135.

*Time of event*

(2) The time of the event is when you cease to have the obligation or the part of the obligation.

*Forex realisation gain*

(3) You make a **forex realisation gain** if:

- (a) the amount you receive in respect of the event happening exceeds the net costs of assuming the obligation or the part of the obligation (the net costs are worked out as at the tax recognition time); and
- (b) some or all of the excess is attributable to a \*currency exchange rate effect.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 775-50**

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The amount of the **forex realisation gain** is so much of the excess as is attributable to a currency exchange rate effect.

Note 1: For **net costs of assuming the obligation**, see section 775-100.

Note 2: For **tax recognition time**, see subsection (7).

Note 3: For **currency exchange rate effect**, see section 775-105.

- (4) You make a **forex realisation gain** if:
- (a) the event happens because an option to sell \*foreign currency expires without having been exercised, or is cancelled, released or abandoned; and
  - (b) if the option had been exercised immediately before the event, you would have been obliged to buy the foreign currency.

The amount of the **forex realisation gain** is the amount you received in return for granting or assuming obligations under the option.

*Forex realisation loss*

- (5) You make a **forex realisation loss** if:
- (a) the amount you receive in respect of the event happening falls short of the net costs of assuming the obligation or the part of the obligation (the net costs are worked out as at the tax recognition time); and
  - (b) some or all of the shortfall is attributable to a \*currency exchange rate effect.

The amount of the **forex realisation loss** is so much of the shortfall as is attributable to a currency exchange rate effect.

Note 1: For **net costs of assuming the obligation**, see section 775-100.

Note 2: For **tax recognition time**, see subsection (7).

Note 3: For **currency exchange rate effect**, see section 775-105.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Non-cash benefit*

- (6) The amount you receive in respect of the event happening can include a \*non-cash benefit. Use the \*market value of the benefit to work out the amount you receive.

*Tax recognition time*

- (7) For the purposes of this section, the **tax recognition time** is the time when you received an amount in respect of the event happening.

*Right to pay Australian currency*

- (8) To avoid doubt, for the purposes of this section, a **right to pay Australian currency** includes a right to pay Australian currency, where the right is subject to a contingency.

**775-55 Ceasing to have an obligation to pay foreign currency—forex realisation event 4**

*Forex realisation event 4*

- (1) **Forex realisation event 4** happens if:
- (a) you cease to have an obligation, or a part of an obligation, to pay \*foreign currency; and
  - (b) any of the following applies:
    - (i) the obligation, or the part of the obligation, is an expense or outgoing that you deduct;
    - (ii) the obligation, or the part of the obligation, is an element in the calculation of a net amount included in your assessable income (other than under this Division or Division 102 of this Act or Division 5 or 6 of Part III of the *Income Tax Assessment Act 1936*);
    - (iii) the obligation, or the part of the obligation, is an element in the calculation of a net amount that is deductible (other than under Division 5 of Part III of the *Income Tax Assessment Act 1936*);

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-55

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- (iv) you incurred the obligation, or the part of the obligation, in return for the acquisition of a \*CGT asset;
- (v) you incurred the obligation, or the part of the obligation, as the second, third, fourth or fifth element of the \*cost base of a CGT asset;
- (vi) you incurred the obligation, or the part of the obligation, in return for your starting to hold a \*depreciating asset, and you deduct an amount under Division 40 or 328 for the depreciating asset;
- (vii) you incurred the obligation, or the part of the obligation, as the second element of the \*cost of a depreciating asset, and you deduct an amount under Division 40 or 328 for the depreciating asset;
- (viii) you incurred the obligation, or the part of the obligation, as a \*project amount;
- (ix) you incurred the obligation, or the part of the obligation, in return for receiving an amount of Australian currency or foreign currency;
- (x) you incurred the obligation, or the part of the obligation, in return for the creation or acquisition of a right to receive an amount of Australian currency or foreign currency;
- (xi) the obligation, or the part of the obligation, is under an option to buy foreign currency.

Note: For extended meaning of *obligation to pay foreign currency*, see section 775-140.

*Time of event*

- (2) The time of the event is when you cease to have the obligation or the part of the obligation.

*Forex realisation gain*

- (3) You make a **forex realisation gain** if:
  - (a) the amount you paid in respect of the event happening falls short of the proceeds of assuming the obligation or the part of

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

the obligation (the proceeds are worked out as at the tax recognition time); and

- (b) some or all of the shortfall is attributable to a \*currency exchange rate effect.

The amount of the **forex realisation gain** is so much of the shortfall as is attributable to a currency exchange rate effect.

Note 1: For **proceeds of assuming the obligation**, see section 775-95.

Note 2: For **tax recognition time**, see subsection (7).

Note 3: For **currency exchange rate effect**, see section 775-105.

- (4) You make a **forex realisation gain** if:
  - (a) the event happens because an option to buy \*foreign currency expires without having been exercised, or is cancelled, released or abandoned; and
  - (b) if the option had been exercised immediately before the event, you would have been obliged to sell the foreign currency.

The amount of the **forex realisation gain** is the amount you received in return for granting or assuming obligations under the option.

*Forex realisation loss*

- (5) You make a **forex realisation loss** if:
  - (a) the amount you paid in respect of the event happening exceeds the proceeds of assuming the obligation or the part of the obligation (the proceeds are worked out as at the tax recognition time); and
  - (b) some or all of the excess is attributable to a \*currency exchange rate effect.

The amount of the **forex realisation loss** is so much of the excess as is attributable to a currency exchange rate effect.

Note 1: For **proceeds of assuming the obligation**, see section 775-95.

Note 2: For **tax recognition time**, see subsection (7).

Note 3: For **currency exchange rate effect**, see section 775-105.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-55

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*Non-cash benefit*

- (6) The amount you paid in respect of the event happening can include a \*non-cash benefit. Use the \*market value of the benefit to work out the amount you paid.

*Tax recognition time*

- (7) For the purposes of this section, the **tax recognition time** is worked out using the table:

<b>Tax recognition time</b>		
<b>Item</b>	<b>In this case...</b>	<b>the tax recognition time is...</b>
1	(a) the obligation, or the part of the obligation, is an expense or outgoing that you deduct; and (b) the obligation, or the part of the obligation, was not incurred: (i) in return for the acquisition of an item of *trading stock; or (ii) in return for your starting to hold a *depreciating asset; and (c) the obligation, or the part of the obligation, was not incurred as the second element of the cost of a depreciating asset	the time when the expense or outgoing became deductible.
2	(a) the obligation, or the part of the obligation, is an expense or outgoing that you deduct; and (b) the obligation, or the part of the obligation, was incurred in return for the acquisition of an item of *trading stock	the time when the item becomes part of your trading stock on hand.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-55

<b>Tax recognition time</b>		
<b>Item</b>	<b>In this case...</b>	<b>the tax recognition time is...</b>
3	the obligation, or the part of the obligation, is an element in the calculation of a net amount included in your assessable income (other than under this Division or Division 102 of this Act or Division 5 or 6 of Part III of the <i>Income Tax Assessment Act 1936</i> )	the time of the determination of the exchange rate used to translate the element for the purpose of calculating the net amount.
4	the obligation, or the part of the obligation, is an element in the calculation of a net amount that is deductible (other than under Division 5 of Part III of the <i>Income Tax Assessment Act 1936</i> )	the time of the determination of the exchange rate used to translate the element for the purpose of calculating the net amount.
5	(a) you incurred the obligation, or the part of the obligation: (i) in return for your starting to hold a *depreciating asset; or (ii) as the second element of the cost of a depreciating asset; and (b) you deduct an amount under Division 40 or 328 for the depreciating asset	(a) in the case of the acquisition of a depreciating asset—when you began to hold the depreciating asset (worked out under Division 40); or (b) in the case of the second element of the cost of a depreciating asset—when you incurred the relevant expenditure.
6	you incurred the obligation, or the part of the obligation, as a *project amount	the first time when any part of the amount became deductible.
7	the obligation, or the part of the obligation, is referred to in subsection 775-165(5) (which deals with extension of loans)	the extension time referred to in that subsection.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-55

<b>Tax recognition time</b>		
<b>Item</b>	<b>In this case...</b>	<b>the tax recognition time is...</b>
8	you incurred the obligation, or the part of the obligation, in return for: (a) receiving Australian currency or *foreign currency; or (b) the creation or acquisition of a right to receive an amount of Australian currency or foreign currency; where item 7 does not apply	the time when you received the currency.
9	(a) you incurred the obligation, or the part of the obligation, in return for the acquisition of a *CGT asset; and (b) none of the above items apply	the time when you acquired the CGT asset (worked out under Division 109).
10	(a) you incurred the obligation, or the part of the obligation, as the second, third, fourth or fifth element of the *cost base of a CGT asset; and (b) none of the above items apply	the time of the transaction under which you incurred the obligation.
<p>Note 1: Foreign currency is a CGT asset. If you acquire foreign currency as the borrower under a loan, item 8 will apply to your obligation to repay the foreign currency borrowed under the loan.</p> <p>Note 2: If you have made a choice for roll-over relief for a facility agreement, and forex realisation event 7 (material variation of a facility agreement) happens, subsection 775-220(6) modifies the tax recognition time for an obligation under a security that was in existence under the agreement at the time of that event.</p> <p>Note 3: Subsection 775-260(2) modifies the tax recognition time if forex realisation event 4 happens in relation to a qualifying forex account that has ceased to pass the limited balance test.</p> <p>Note 4: If you have made a choice for roll-over relief for a facility agreement, a forex realisation gain or forex realisation loss you make under the agreement as a result of forex realisation event 4 is disregarded—see section 775-200.</p>		

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**775-60 Ceasing to have a right to pay foreign currency—forex  
realisation event 5**

*Forex realisation event 5*

- (1) **Forex realisation event 5** happens if:
- (a) you cease to have a right, or a part of a right, to pay \*foreign currency; and
  - (b) the right, or the part of the right, is one of the following:
    - (i) a right, or a part of a right, created or acquired in return for the assumption of an obligation to pay foreign currency;
    - (ii) a right, or a part of a right, created or acquired in return for the assumption of an obligation to pay Australian currency;
    - (iii) a right, or a part of a right, under an option to sell foreign currency.

Note 1: For extended meaning of *right to pay foreign currency*, see section 775-135.

Note 2: For extended meaning of *obligation to pay foreign currency*, see section 775-140.

*Time of event*

- (2) The time of the event is when you cease to have the right or the part of the right.

*Forex realisation gain*

- (3) You make a **forex realisation gain** if:
- (a) the amount you pay in respect of the event happening falls short of the \*forex entitlement base of the right or the part of the right (the forex entitlement base is worked out as at the tax recognition time); and
  - (b) some or all of the shortfall is attributable to a \*currency exchange rate effect.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 775-60**

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The amount of the **forex realisation gain** is so much of the shortfall as is attributable to a currency exchange rate effect.

Note 1: For **forex entitlement base**, see section 775-90.

Note 2: For **tax recognition time**, see subsection (7).

Note 3: For **currency exchange rate effect**, see section 775-105.

**Forex realisation loss**

- (4) You make a **forex realisation loss** if:
- (a) the amount you pay in respect of the event happening exceeds the \*forex entitlement base of the right or the part of the right (the forex entitlement base is worked out as at the tax recognition time); and
  - (b) some or all of the excess is attributable to a \*currency exchange rate effect.

The amount of the **forex realisation loss** is so much of the excess as is attributable to a currency exchange rate effect.

Note 1: For **forex entitlement base**, see section 775-90.

Note 2: For **tax recognition time**, see subsection (7).

Note 3: For **currency exchange rate effect**, see section 775-105.

- (5) You make a **forex realisation loss** if:
- (a) the event happens because an option to sell \*foreign currency expires without having been exercised, or is cancelled, released or abandoned; and
  - (b) you were capable of exercising the option immediately before the event happened.

The amount of the **forex realisation loss** is the amount you paid in return for the grant or acquisition of the option.

**Non-cash benefit**

- (6) The amount you pay in respect of the event happening can include a \*non-cash benefit. Use the \*market value of the benefit to work out the amount you pay.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

*Tax recognition time*

- (7) For the purposes of this section, the **tax recognition time** is the time when you pay an amount in respect of the event happening.

*Obligation to pay Australian currency*

- (8) To avoid doubt, for the purposes of this section, an **obligation to pay Australian currency** includes an obligation to pay Australian currency, where the obligation is subject to a contingency.

**775-65 Only one forex realisation event to be counted**

*Option to buy foreign currency*

- (1) The following table applies to an option to buy a particular \*foreign currency if the exercise price is payable in another foreign currency:

<b>Option to buy foreign currency</b>			
<b>Item</b>	<b>If you are...</b>	<b>and both of these events happen when the option is exercised...</b>	<b>this is the result...</b>
1	the entity who is capable of exercising the option	(a) forex realisation event 1; (b) forex realisation event 4	ignore forex realisation event 4.
2	the entity who is capable of exercising the option	(a) forex realisation event 2; (b) forex realisation event 4	ignore forex realisation event 4.
3	the entity who granted the option	(a) forex realisation event 3; (b) forex realisation event 4	ignore forex realisation event 3.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 775-65**

*Option to sell foreign currency*

- (2) The following table applies to an option to sell a particular \*foreign currency if the exercise price is payable in another foreign currency:

<b>Option to sell foreign currency</b>			
<b>Item</b>	<b>If you are...</b>	<b>and both of these events happen when the option is exercised...</b>	<b>this is the result...</b>
1	the entity who is capable of exercising the option	(a) forex realisation event 3; (b) forex realisation event 5	ignore forex realisation event 3.
2	the entity who granted the option	(a) forex realisation event 3; (b) forex realisation event 4	ignore forex realisation event 3.

*Forward contracts*

- (3) The following table applies to a contract to buy a particular \*foreign currency in return for another foreign currency:

<b>Forward contracts</b>		
<b>Item</b>	<b>If both of these events happen when the contract is carried out...</b>	<b>this is the result...</b>
1	(a) forex realisation event 1; (b) forex realisation event 4	ignore forex realisation event 4.
2	(a) forex realisation event 2; (b) forex realisation event 4	ignore forex realisation event 4.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

*Residual rule*

- (4) If:
- (a) 2 or more of forex realisation events 1, 2, 3, 4 and 5 happen to you at the same time in relation to the same rights and/or obligations; and
  - (b) none of the above subsections applies;
- apply the forex realisation event that is most appropriate, and ignore the remaining event or events.

**775-70 Tax consequences of certain short-term forex realisation gains**

- (1) The following table has effect unless you have made a choice under section 775-80:

<b>Tax consequences of certain short-term forex realisation gains</b>		
<b>Item</b>	<b>In this case...</b>	<b>this is the result...</b>
1	you make a *forex realisation gain as a result of forex realisation event 2, and: <ul style="list-style-type: none"><li>(a) the right to receive *foreign currency was created in return for the occurrence of a *realisation event in relation to a *CGT asset you own; and</li><li>(b) item 6 of the table in subsection 775-45(7) applies; and</li><li>(c) the foreign currency became due for payment within 12 months after the occurrence of the realisation event</li></ul>	<ul style="list-style-type: none"><li>(a) the forex realisation gain is not included in your assessable income under section 775-15; and</li><li>(b) CGT event K10 happens.</li></ul>

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-70

<b>Tax consequences of certain short-term forex realisation gains</b>		
<b>Item</b>	<b>In this case...</b>	<b>this is the result...</b>
2	<p>you make a *forex realisation gain as a result of forex realisation event 4, and:</p> <p>(a) the obligation to pay *foreign currency was incurred:</p> <p>(i) in return for the acquisition of a *CGT asset; or</p> <p>(ii) as the second, third, fourth or fifth element of the *cost base of a CGT asset; and</p> <p>(b) item 9 of the table in subsection 775-55(7) applies; and</p> <p>(c) the foreign currency became due for payment within 12 months after the time when:</p> <p>(i) if subparagraph (a)(i) applies—you acquired the CGT asset (worked out under Division 109); or</p> <p>(ii) if subparagraph (a)(ii) applies—you incurred the relevant expenditure</p>	<p>(a) the forex realisation gain is not included in your assessable income under section 775-15; and</p> <p>(b) both the *cost base and the *reduced cost base of the CGT asset are reduced by an amount equal to the forex realisation gain.</p>
3	<p>you make a *forex realisation gain as a result of forex realisation event 4, and:</p> <p>(a) the obligation to pay *foreign currency was incurred:</p> <p>(i) in return for your starting to hold a *depreciating asset; or</p>	<p>(a) the forex realisation gain is not included in your assessable income under section 775-15; and</p> <p>(b) if:</p> <p>(i) the forex realisation event happens in the income year in which the asset's *start time occurs; and</p> <p>(ii) the asset is not allocated to a</p>

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



**Tax consequences of certain short-term forex realisation gains**

<b>Item</b>	<b>In this case...</b>	<b>this is the result...</b>
	(ii) as the second element of the cost of a depreciating asset; and	pool under Subdivision 40-E or 328-D;
(b)	if subparagraph (a)(i) applies—the foreign currency became due for payment within the 24-month period that began 12 months before the time when you began to hold the depreciating asset (worked out under Division 40); and	the asset's *cost is reduced (but not below zero) by an amount equal to the forex realisation gain; and
(c)	if subparagraph (a)(ii) applies—the foreign currency became due for payment within 12 months after the time when you incurred the relevant expenditure	(c) if: <ul style="list-style-type: none"> <li>(i) the forex realisation event happens in an income year that is later than the one in which the asset's *start time occurs; and</li> <li>(ii) the asset is not allocated to a pool under Subdivision 40-E or 328-D;</li> </ul> the depreciating asset's *opening adjustable value for the income year in which the forex realisation event happens is reduced (but not below zero) by an amount equal to the forex realisation gain; and
		(d) if the asset is allocated to a pool under Subdivision 40-E or 328-D—the opening pool balance of the pool for the income year in which the forex realisation event happens is reduced (but not below zero) by an amount equal to the forex realisation gain.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-70

<b>Tax consequences of certain short-term forex realisation gains</b>		
<b>Item</b>	<b>In this case...</b>	<b>this is the result...</b>
4	<p>you make a *forex realisation gain as a result of forex realisation event 4, and:</p> <p>(a) the obligation to pay *foreign currency was incurred as a project amount; and</p> <p>(b) the foreign currency became due for payment within 12 months after the time when you incurred the project amount; and</p> <p>(c) the project amount is allocated to a project pool</p>	<p>(a) the forex realisation gain is not included in your assessable income under section 775-15; and</p> <p>(b) the pool value of the project pool for the income year in which you incurred the project amount is reduced (but not below zero) by an amount equal to the forex realisation gain.</p>

*Additional result where forex realisation gain exceeds cost etc.*

(2) The following table has effect:

<b>Additional result where forex realisation gain exceeds cost etc.</b>			
<b>Item</b>	<b>If...</b>	<b>and the following conditions are satisfied...</b>	<b>this is the result...</b>
1	<p>item 3 of the table in subsection (1) applies in relation to a *depreciating asset</p>	<p>(a) the forex realisation event happens in the income year in which the asset's *start time occurs; and</p> <p>(b) the asset is not allocated to a pool under Subdivision 40-E or 328-D; and</p> <p>(c) the forex realisation gain exceeds the asset's *cost</p>	<p>the excess is included in your assessable income.</p>

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-70

<b>Additional result where forex realisation gain exceeds cost etc.</b>			
<b>Item</b>	<b>If...</b>	<b>and the following conditions are satisfied...</b>	<b>this is the result...</b>
2	item 3 of the table in subsection (1) applies in relation to a *depreciating asset	(a) the forex realisation event happens in an income year that is later than the one in which the asset's *start time occurs; and (b) the asset is not allocated to a pool under Subdivision 40-E or 328-D; and (c) the forex realisation gain exceeds the asset's *opening adjustable value for the income year in which the forex realisation event happens	the excess is included in your assessable income.
3	item 3 of the table in subsection (1) applies in relation to a *depreciating asset	(a) the asset is allocated to a pool under Subdivision 40-E or 328-D; and (b) the forex realisation gain exceeds the opening pool balance of the pool for the income year in which the forex realisation event happens	the excess is included in your assessable income.
4	item 4 of the table in subsection (1) applies in relation to a project amount	the forex realisation gain exceeds the pool value of the project pool for the income year in which you incurred the project amount	the excess is included in your assessable income.

- (3) To the extent that a \*forex realisation gain:
- (a) would have been included in your assessable income under section 775-15 if this section had not been enacted; and
  - (b) would, apart from this subsection, be included in your assessable income under another provision of this Act;
- the gain is not included in your assessable income under that other provision.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-75

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**775-75 Tax consequences of certain short-term forex realisation losses**

- (1) The following table has effect unless you have made a choice under section 775-80:

<b>Tax consequences of certain short-term forex realisation losses</b>		
<b>Item</b>	<b>In this case...</b>	<b>this is the result...</b>
1	you make a *forex realisation loss as a result of forex realisation event 2, and:  (a) the right to receive *foreign currency was created in return for the occurrence of a *realisation event in relation to a *CGT asset you own; and  (b) item 6 of the table in subsection 775-45(7) applies; and  (c) the foreign currency became due for payment within 12 months after the occurrence of the realisation event	(a) the forex realisation loss is not deductible under section 775-30; and  (b) CGT event K11 happens.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-75

<b>Tax consequences of certain short-term forex realisation losses</b>		
<b>Item</b>	<b>In this case...</b>	<b>this is the result...</b>
2	<p>you make a *forex realisation loss as a result of forex realisation event 4, and:</p> <p>(a) the obligation to pay *foreign currency was incurred:</p> <p>(i) in return for the acquisition of a *CGT asset; or</p> <p>(ii) as the second, third, fourth or fifth element of the *cost base of a CGT asset; and</p> <p>(b) item 9 of the table in subsection 775-55(7) applies; and</p> <p>(c) the foreign currency became due for payment within 12 months after the time when:</p> <p>(i) if subparagraph (a)(i) applies—you acquired the CGT asset (worked out under Division 109); or</p> <p>(ii) if subparagraph (a)(ii) applies—you incurred the relevant expenditure</p>	<p>(a) the forex realisation loss is not deductible under section 775-30; and</p> <p>(b) both the *cost base and the *reduced cost base of the CGT asset are increased by an amount equal to the *forex realisation loss.</p>
3	<p>you make a *forex realisation loss as a result of forex realisation event 4, and:</p> <p>(a) the obligation to pay *foreign currency was incurred:</p> <p>(i) in return for your starting to hold a *depreciating asset; or</p> <p>(ii) as the second element of the cost of a depreciating asset; and</p> <p>(b) if subparagraph (a)(i) applies—the foreign currency became due</p>	<p>(a) the forex realisation loss is not deductible under section 775-30; and</p> <p>(b) if:</p> <p>(i) the forex realisation event happens in the income year in which the asset's *start time occurs; and</p> <p>(ii) the asset is not allocated to a pool under Subdivision 40-E or 328-D;</p> <p>the asset's *cost is increased by</p>

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-75

<b>Tax consequences of certain short-term forex realisation losses</b>		
<b>Item</b>	<b>In this case...</b>	<b>this is the result...</b>
	<p>for payment within the 24-month period that began 12 months before the time when you began to hold the depreciating asset (worked out under Division 40); and</p> <p>(c) if subparagraph (a)(ii) applies—the foreign currency became due for payment within 12 months after the time when you incurred the relevant expenditure</p>	<p>an amount equal to the forex realisation loss; and</p> <p>(c) if:</p> <p>(i) the forex realisation event happens in an income year that is later than the one in which the asset's *start time occurs; and</p> <p>(ii) the asset is not allocated to a pool under Subdivision 40-E or 328-D;</p> <p>the depreciating asset's *opening adjustable value for the income year in which the forex realisation event happens is increased by an amount equal to the forex realisation loss; and</p> <p>(d) if the asset is allocated to a pool under Subdivision 40-E or 328-D—the opening pool balance of the pool for the income year in which the forex realisation event happens is increased by an amount equal to the forex realisation loss.</p>
4	<p>you make a *forex realisation loss as a result of forex realisation event 4, and:</p> <p>(a) the obligation to pay *foreign currency was incurred as a project amount; and</p> <p>(b) the foreign currency became due for payment within 12 months after the time when you incurred the project amount</p>	<p>(a) the forex realisation loss is not deductible under section 775-30; and</p> <p>(b) the pool value of the project pool for the income year in which you incurred the project amount is increased by an amount equal to the forex realisation loss.</p>

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (2) To the extent that:
  - (a) section 775-30 would have allowed you a deduction for a  
\*forex realisation loss if this section had not been enacted;  
and
  - (b) apart from this subsection, another provision of this Act  
would allow you a deduction for the loss;  
you cannot deduct the loss under that other provision.

**775-80 You may choose not to have sections 775-70 and 775-75 apply to you**

- (1) You may choose not to have sections 775-70 and 775-75 apply to you.
  - (2) A choice must be in writing.
  - (3) A choice must be made:
    - (a) if you were in existence at the start of the applicable commencement date:
      - (i) within 90 days after the applicable commencement date;  
or
      - (ii) within 30 days after the commencement of this subsection; or
    - (b) if you came into existence within 90 days after the start of the applicable commencement date:
      - (i) within 90 days after you came into existence; or
      - (ii) within 30 days after the commencement of this subsection; or
    - (c) if the Commissioner allows a longer period—within that longer period.
- Note: For *applicable commencement date*, see section 775-155.
- (4) A choice has effect from the start of the applicable commencement date.
  - (5) A choice may not be revoked.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-85

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**775-85 Forex cost base of a right to receive foreign currency**

The *forex cost base* of a right, or a part of a right, to receive \*foreign currency is the total of:

- (a) the money you:
    - (i) paid; or
    - (ii) are required to pay; or
    - (iii) would be required to pay in the event of the exercise of an option;in respect of acquiring the right or part of the right; and
  - (b) the \*market value of any \*non-cash benefit you:
    - (i) provided; or
    - (ii) are required to provide; or
    - (iii) would be required to provide in the event of the exercise of an option;in respect of acquiring the right or part of the right;
- reduced by any amounts that are deductible under a provision of this Act other than this Division.

**775-90 Forex entitlement base of a right to pay foreign currency**

The *forex entitlement base* of a right, or a part of a right, to pay \*foreign currency is the total of:

- (a) the money you:
  - (i) are entitled to receive; or
  - (ii) would be entitled to receive in the event of the exercise of an option;in respect of the discharge or satisfaction of the right or the part of the right; and
- (b) the \*market value of any \*non-cash benefit you:
  - (i) are entitled to acquire or obtain; or
  - (ii) would be entitled to acquire or obtain in the event of the exercise of an option;in respect of the discharge or satisfaction of the right or the part of the right;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



reduced by:

- (c) any amounts that you paid to acquire the right or the part of the right, where the amounts are not deductible under a provision of this Act other than this Division; and
- (d) the market value of any non-cash benefit that you provided to acquire the right or the part of the right, where the market value is not deductible under a provision of this Act other than this Division.

### **775-95 Proceeds of assuming an obligation to pay foreign currency**

For the purposes of this Division, the *proceeds* of assuming an obligation, or a part of an obligation, to pay \*foreign currency are the total of:

- (a) the money you:
  - (i) received; or
  - (ii) are entitled to receive; or
  - (iii) would be entitled to receive in the event of the exercise of an option;in return for incurring the obligation or the part of the obligation; and
- (b) the \*market value of any \*non-cash benefit you:
  - (i) acquired or obtained; or
  - (ii) are entitled to acquire or obtain; or
  - (iii) would be entitled to acquire or obtain in the event of the exercise of an option;in return for incurring the obligation or the part of the obligation;

reduced by any amounts that are included in assessable income under a provision of this Act other than this Division.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-100

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**775-100 Net costs of assuming an obligation to receive foreign currency**

- (1) For the purposes of this Division, the *net costs* of assuming an obligation, or a part of an obligation, to receive \*foreign currency are the total of:
- (a) the money you:
    - (i) are required to pay; or
    - (ii) would be required to pay in the event of the exercise of an option;in respect of the fulfilment of the obligation or the part of the obligation; and
  - (b) the \*market value of any \*non-cash benefit you:
    - (i) are required to provide; or
    - (ii) would be required to provide in the event of the exercise of an option;in respect of the fulfilment of the obligation or the part of the obligation;
- reduced by the amount worked out under subsection (2).
- (2) The amount worked out under this subsection is the total of:
- (a) the money you:
    - (i) received; or
    - (ii) are entitled to receive;because you incurred the obligation or the part of the obligation; and
  - (b) the \*market value of any \*non-cash benefit you:
    - (i) received or obtained; or
    - (ii) are entitled to receive or obtain;because you incurred the obligation or the part of the obligation;
- reduced by any amounts that are included in assessable income under a provision of this Act other than this Division.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (3) To avoid doubt, paragraphs (2)(a) and (b) do not apply to money or a \*non-cash benefit that you:
- (a) received or obtained; or
  - (b) are entitled to receive or obtain;
- because of the fulfilment of the obligation or the part of the obligation.

### **775-105 Currency exchange rate effect**

- (1) A *currency exchange rate effect* is:
- (a) any currency exchange rate fluctuations; or
  - (b) a difference between:
    - (i) an expressly or implicitly agreed currency exchange rate for a future date or time; and
    - (ii) the applicable currency exchange rate at that date or time.
- (2) To work out whether there is a currency exchange rate effect and (if so), the extent of that effect, use whichever of the following translation rules is applicable to you:
- (a) the translation rules in section 960-50 (the standard rules);
  - (b) the translation rules in section 960-80 (the functional currency rules).

### **775-110 Constructive receipts and payments**

For the purposes of this Subdivision, if an entity (the *payer*) did not actually pay an amount to another entity (the *recipient*), but the amount was applied or dealt with in any way on the recipient's behalf or as the recipient directs (including by discharging all or a part of an obligation owed by the recipient), then:

- (a) the payer is taken to have paid the amount as soon as it is applied or dealt with; and
- (b) the recipient is taken to have received the amount as soon as it is applied or dealt with.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 775-115**

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Note: The set-off of an obligation to pay an amount against a right to receive an amount is an example of how this section would operate.

**775-115 Economic set-off to be treated as legal set-off**

If the economic effect of an \*arrangement is to provide for the set-off, in whole or in part, of one or more amounts against one or more other amounts, this Subdivision applies as if:

- (a) the parties to the arrangement had the respective rights and obligations that they would have had if the provision for economic set-off were structured as a provision for legal set-off of rights and obligations; and
- (b) if the economic set-off happens—the parties were taken, under section 775-110, to have paid and received the respective amounts that they would have paid and received if the economic set-off were structured as a legal set-off of rights and obligations.

**775-120 Non-arm's length transactions**

If:

- (a) you and another entity did not deal with each other at \*arm's length in connection with a transaction that is relevant to working out:
  - (i) whether you make a \*forex realisation gain or a \*forex realisation loss; or
  - (ii) the amount of any \*forex realisation gain or a \*forex realisation loss made by you; and
- (b) apart from this section, a particular amount is more or less than it would have been if you and the other entity had been dealing with each other at arm's length;

this Subdivision applies to you as if that amount were the amount it would have been if you and the other entity had been dealing with each other at arm's length.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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### **775-125 CGT consequences of the acquisition of foreign currency as a result of forex realisation event 2 or 3**

If you acquire \*foreign currency as a result of forex realisation event 2 or 3:

- (a) the first element of the foreign currency's \*cost base is replaced by the foreign currency's \*market value at the time you received the foreign currency; and
- (b) the first element of the foreign currency's \*reduced cost base is replaced by the foreign currency's market value at the time you received the foreign currency.

### **775-130 Certain deductions not allowable**

If:

- (a) an amount is included in your assessable income under this Division; and
- (b) if this Division had not been enacted, the amount would not have been included in your assessable income under any other provision of this Act (other than Division 102); and
- (c) if this section had not been enacted, a deduction would be allowable to you under a provision listed in the table in subsection 51AAA(2) of the *Income Tax Assessment Act 1936*; and
- (d) if the amount had not been included in your assessable income under this Division, the deduction would not be allowable;

the deduction is not allowable.

### **775-135 Right to receive or pay foreign currency**

*Extended meaning of **right to receive foreign currency***

- (1) For the purposes of this Division, a **right to receive foreign currency** includes a right to receive an amount calculated by reference to a currency exchange rate effect, even if that amount is not an amount of \*foreign currency.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-140

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- (2) To avoid doubt, for the purposes of this Division, a ***right to receive foreign currency*** includes a right to receive \*foreign currency, where the right is subject to a contingency.

*Extended meaning of right to pay foreign currency*

- (3) For the purposes of this Division, a ***right to pay foreign currency*** includes a right to pay an amount calculated by reference to a currency exchange rate effect, even if that amount is not an amount of \*foreign currency.
- (4) To avoid doubt, for the purposes of this Division, a ***right to pay foreign currency*** includes a right to pay \*foreign currency, where the right is subject to a contingency.

**775-140 Obligation to pay or receive foreign currency**

*Extended meaning of obligation to pay foreign currency*

- (1) For the purposes of this Division, an ***obligation to pay foreign currency*** includes an obligation to pay an amount calculated by reference to a currency exchange rate effect, even if that amount is not an amount of \*foreign currency.
- (2) To avoid doubt, for the purposes of this Division, an ***obligation to pay foreign currency*** includes an obligation to pay \*foreign currency, where the obligation is subject to a contingency.

*Extended meaning of obligation to receive foreign currency*

- (3) For the purposes of this Division, an ***obligation to receive foreign currency*** includes an obligation to receive an amount calculated by reference to a currency exchange rate effect, even if that amount is not an amount of \*foreign currency.
- (4) To avoid doubt, for the purposes of this Division, an ***obligation to receive foreign currency*** includes an obligation to receive \*foreign currency, where the obligation is subject to a contingency.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**775-145 Application of forex realisation events to currency and fungible rights and obligations**

- (1) Forex realisation event 1, 2 or 4 applies in relation to:
  - (a) \*foreign currency; or
  - (b) a fungible right, or a part of a fungible right, to receive foreign currency; or
  - (c) a fungible obligation, or a part of a fungible obligation, to pay foreign currency;on a first-in first-out basis.
- (2) The regulations may provide that any or all of forex realisation events 1, 2 and 4 apply, or apply in specified circumstances, to:
  - (a) \*foreign currency; or
  - (b) a fungible right, or a part of a fungible right, to receive foreign currency; or
  - (c) a fungible obligation, or a part of a fungible obligation, to pay foreign currency;on a weighted average basis (despite subsection (1)).
- (3) The circumstances that may be specified for the purposes of subsection (2) include the circumstance that you have made an election to use a weighted average basis.
- (4) Subsection (3) does not limit subsection (2).

**775-150 Transitional election**

- (1) You may elect to have this section apply to you.

Note: For the consequences of an election, see sections 775-160 and 775-165.
- (2) An election must be in writing.
- (3) An election must be made:
  - (a) within 60 days after the applicable commencement date; or
  - (b) within 30 days after the commencement of this subsection.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 775-155**

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Note: For *applicable commencement date*, see section 775-155.

- (4) An election may not be revoked.

**775-155 Applicable commencement date**

For the purposes of this Division, your *applicable commencement date* is:

- (a) the first day of the 2003-04 income year; or
- (b) if that day is earlier than 1 July 2003—the first day of the 2004-05 income year.

**775-160 Exception—event happens before the applicable commencement date**

- (1) A \*forex realisation gain or \*forex realisation loss you make as a result of forex realisation event 1, 2, 3, 4 or 5 is disregarded if the event happened before the applicable commencement date.

Note: For *applicable commencement date*, see section 775-155.

- (2) Subsection (1) does not apply if:
- (a) you have made an election under section 775-150; and
  - (b) the Commissioner is satisfied that the event happened under, or as a result of, an \*arrangement that was entered into or carried out for the purpose, or for purposes that included the purpose, of obtaining the benefit of the operation of subsection (1).

**775-165 Exception—currency or right acquired, or obligation incurred, before the applicable commencement date**

*Exception—foreign currency acquired before the applicable commencement date*

- (1) A \*forex realisation gain or \*forex realisation loss you make on the disposal of \*foreign currency as a result of forex realisation event 1 is disregarded if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



- (a) the foreign currency was acquired before the applicable commencement date; and
- (b) you have not made an election under section 775-150.

For the purposes of paragraph (a), the time of acquisition is worked out under Division 109.

Note: For *applicable commencement date*, see section 775-155.

*Exception—right acquired before the applicable commencement date*

- (2) A \*forex realisation gain or \*forex realisation loss you make as a result of forex realisation event 1, 2 or 5 happening to a right or a part of a right is disregarded if:
  - (a) the right, or the part of the right;
    - (i) was acquired before the applicable commencement date; or
    - (ii) arose under an eligible contract (within the meaning of the former Division 3B of Part III of the *Income Tax Assessment Act 1936*) that was entered into before the applicable commencement date; and
  - (b) you have not made an election under section 775-150.

For the purposes of subparagraph (a)(i), the time of acquisition is worked out under Division 109.

Note: For *applicable commencement date*, see section 775-155.

- (3) If:
  - (a) at a particular time (the *extension time*) on or after the applicable commencement date and under a contract that was entered into before the applicable commencement date, the period for which money has been lent is extended; and
  - (b) either:
    - (i) the contract is separate from the original loan contract; or
    - (ii) the extension amounts to a variation of the original loan contract;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 775-165**

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subparagraph (2)(a)(ii) does not apply to a right, or a part of a right, that arises after the extension time and relates to the loan.

Note: For *applicable commencement date*, see section 775-155.

*Exception—obligation incurred before the applicable commencement date*

- (4) A \*forex realisation gain or \*forex realisation loss you make as a result of forex realisation event 3 or 4 happening to an obligation or a part of an obligation is disregarded if:
- (a) either:
    - (i) you incurred the obligation, or the part of the obligation, before the applicable commencement date; or
    - (ii) the obligation, or the part of the obligation, arose under an eligible contract (within the meaning of the former Division 3B of Part III of the *Income Tax Assessment Act 1936*) that was entered into before the applicable commencement date; and
  - (b) you have not made an election under section 775-150.

Note: For *applicable commencement date*, see section 775-155.

- (5) If:
- (a) at a particular time (the *extension time*) on or after the applicable commencement date and under a contract that was entered into before the applicable commencement date, the period for which money has been lent is extended; and
  - (b) either:
    - (i) the contract is separate from the original loan contract; or
    - (ii) the extension amounts to a variation of the original loan contract;

subparagraph (4)(a)(ii) does not apply to an obligation, or a part of an obligation, that arises after the extension time and relates to the loan.

Note: For *applicable commencement date*, see section 775-155.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## **775-168 Exception—disposal or redemption of traditional securities**

A \*forex realisation gain or \*forex realisation loss you make as a result of forex realisation event 2 is disregarded if the event happened because of a disposal or redemption covered by:

- (a) subsection 26BB(4) or (5) of the *Income Tax Assessment Act 1936*; or
- (b) subsection 70B(2B) or (2C) of that Act.

## **775-175 Application to things happening before commencement**

The use of the present tense in a provision of this Division does not imply that the provision does not apply to things happening before the commencement of this Division.

## **Subdivision 775-C—Roll-over relief for facility agreements**

### **Guide to Subdivision 775-C**

#### **775-180 What this Subdivision is about**

A *facility agreement* is an agreement where:

- (a) you have a right to issue eligible securities and another entity or entities must acquire the securities; and
- (b) the economic effect of the agreement is to enable you to obtain finance in a particular foreign currency.

If you choose roll-over relief for a facility agreement:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-180

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- (a) a forex realisation gain or a forex realisation loss you make as a result of forex realisation event 4 is disregarded if the event happens because you discharge your obligation under an eligible security issued by you under the agreement; and
- (b) if you issue an eligible security under the agreement otherwise than as a result of a roll-over—you are taken to have been given a loan (the ***notional loan***); and
- (c) if an eligible security is rolled-over under the agreement—the period of the notional loan is extended by the term of the new security; and
- (d) forex realisation event 6 happens if you discharge your obligation under the notional loan; and
- (e) forex realisation event 7 happens if a material variation is made to the agreement.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Operative provisions

### 775-185 What is a *facility agreement*?

A *facility agreement* is an agreement between an entity (the *first entity*) and another entity or entities under which:

- (a) the first entity has a right to issue \*eligible securities; and
  - (b) an entity or entities must acquire the securities;
- where the economic effect of the agreement is to enable the first entity to obtain finance in a particular \*foreign currency:
- (c) up to the foreign currency amount specified in the agreement; and
  - (d) during the term of the agreement.

### 775-190 What is an *eligible security*?

An *eligible security* is:

- (a) a bill of exchange, or a promissory note, that is:
  - (i) non-interest bearing; and
  - (ii) issued at a discount to face value; and
  - (iii) denominated in a particular \*foreign currency; and
  - (iv) for a fixed term; or
- (b) a security that is:
  - (i) specified in the regulations; and
  - (ii) denominated in a foreign currency; and
  - (iii) for a fixed term.

### 775-195 You may choose roll-over relief for a facility agreement

- (1) You may choose roll-over relief for a \*facility agreement if:
  - (a) you have entered into the agreement; and
  - (b) you have a right to issue \*eligible securities under the agreement; and
  - (c) the economic effect of the agreement is to enable you to obtain finance in a particular \*foreign currency:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 775-195**

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- (i) up to the foreign currency amount specified in the agreement; and
- (ii) during the term of the agreement.

(2) A choice must be made:

- (a) within 90 days after the first time you issue an \*eligible security under the \*facility agreement; or
- (b) within 90 days after the applicable commencement date; or
- (c) within 30 days after the commencement of this subsection.

Note: For **applicable commencement date**, see section 775-155.

(3) If you make a choice within 90 days after the first time you issue an \*eligible security under the \*facility agreement, the choice is taken to have been in effect throughout the period that began immediately before the first time you issued an eligible security under the facility agreement.

(4) If:

- (a) you make a choice:
    - (i) within 90 days after the applicable commencement date; or
    - (ii) within 30 days after the commencement of this subsection; and
  - (b) subsection (3) does not apply;
- the choice is taken to have been in effect throughout the period that began at whichever is the later of the following times:
- (c) the start of the applicable commencement date;
  - (d) the first time you issued an \*eligible security under the \*facility agreement.

Note: For **applicable commencement date**, see section 775-155.

(5) A choice must be in writing.

(6) A choice continues to apply until the \*facility agreement ends.

Note: If forex realisation event 7 happens (material variation of facility agreement), subsection 775-220(5) terminates your choice.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (7) A choice may not be revoked.

### **775-200 Forex realisation event 4 does not apply**

A \*forex realisation gain or a \*forex realisation loss you make as a result of forex realisation event 4 or 9 is disregarded to the extent to which the event happens because:

- (a) you discharge your obligation under an \*eligible security issued by you under a \*facility agreement; and
- (b) you have made a choice for roll-over relief for the facility agreement, and that choice is in effect.

### **775-205 What is a *roll-over*?**

A ***roll-over*** happens under a \*facility agreement if:

- (a) you discharge your obligation under an \*eligible security issued by you under the agreement (the ***rolled-over security***); and
- (b) at the same time, you issue a new eligible security (the ***new security***) under the agreement; and
- (c) the issue of the new security is related to the discharge of your obligation under the rolled-over security in one of the following ways:
  - (i) your obligation under the rolled-over security is wholly or partly set off against your right to receive the \*foreign currency issue price of the new security;
  - (ii) your obligation under the rolled-over security is wholly or partly satisfied by the issue of the new security; and
- (d) you have made a choice for roll-over relief for the agreement, and that choice is in effect; and
- (e) the new security is issued on or after the applicable commencement date; and
- (f) if you have not made an election under section 775-150—the rolled-over security is issued on or after the applicable commencement date.

Note: For ***applicable commencement date***, see section 775-155.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-210

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**775-210 Notional loan**

- (1) The rules in this section have effect only for the purposes of this Subdivision.

*Notional loan*

- (2) If you issue an \*eligible security under a \*facility agreement otherwise than as a result of a roll-over, you are taken to have been given a loan (the **notional loan**):
- (a) of a \*foreign currency principal amount equal to the foreign currency face value of the security; and
  - (b) for a period equal to the term of the security; and
  - (c) that is taken to be attached to the security; and
  - (d) the **start time** of which is the time when you issued the security.

Note 1: The period of the notional loan may be extended as the result of a later roll-over—see subsection (3).

Note 2: The notional loan may become attached to a later security as the result of a roll-over—see subsection (3).

Note 3: The foreign currency principal amount of the notional loan may remain the same, or may fall (but not rise), as a result of a later roll-over—see subsection (3).

Note 4: If, at a later time, the security is rolled-over, and the foreign currency face value of the new security exceeds the foreign currency face value of the rolled-over security, you are taken to have been given an additional notional loan of a foreign currency principal amount equal to the excess—see subsection (3).

*Effect of roll-over*

- (3) The table has effect if an \*eligible security is rolled-over under a \*facility agreement:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



Section 775-210

<b>Roll-over of eligible security</b>		
<b>Item</b>	<b>If the foreign currency face value of the new security...</b>	<b>this is the result...</b>
1	equals the *foreign currency face value of the rolled-over security	<ul style="list-style-type: none"> <li>(a) the period of each notional loan attached to the rolled-over security is extended by the term of the new security; and</li> <li>(b) each notional loan attached to the rolled-over security is taken to be attached to the new security.</li> </ul>
2	exceeds the *foreign currency face value of the rolled-over security	<ul style="list-style-type: none"> <li>(a) you are taken to have been given an additional notional loan: <ul style="list-style-type: none"> <li>(i) of a foreign currency principal amount equal to the excess; and</li> <li>(ii) for a period equal to the term of the new security; and</li> <li>(iii) that is taken to be attached to the new security; and</li> <li>(iv) the start time of which is the time when you issued the new security; and</li> </ul> </li> <li>(b) the period of each notional loan attached to the rolled-over security is extended by the term of the new security; and</li> <li>(c) each notional loan attached to the rolled-over security is taken to be attached to the new security.</li> </ul>

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-210

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<b>Roll-over of eligible security</b>		
<b>Item</b>	<b>If the foreign currency face value of the new security...</b>	<b>this is the result...</b>
3	falls short of the *foreign currency face value of the rolled-over security, and there is only one notional loan attached to the rolled-over security	(a) you are taken to have paid a foreign currency amount equal to the shortfall in order to discharge so much of your obligation to pay the foreign currency principal amount of the notional loan as equals the shortfall; and (b) the period of the notional loan is extended by the term of the new security; and (c) the notional loan is taken to be attached to the new security.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Roll-over of eligible security**

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Item	If the foreign currency face value of the new security...	this is the result...
4	falls short of the * foreign currency face value of the rolled-over security, and there are 2 or more notional loans attached to the rolled-over security	<p>(a) you are taken to have paid a foreign currency amount equal to the shortfall in order to discharge your obligation to pay so much of the total foreign currency principal amounts of the notional loans as equals the shortfall, and to have done so on a first-in first-out basis, that is to say:</p> <p>(i) first, by fully or partly discharging (as the case requires) your obligation to pay the foreign currency principal amount of the notional loan with the earliest start date; and</p> <p>(ii) second, if your obligation to pay the foreign currency principal amount of the notional loan with the earliest start date is fully discharged—by fully or partly discharging (as the case requires) your obligation to pay the foreign currency principal amount of the notional loan with the next start date, and so on; and</p> <p>(b) the period of each notional loan attached to the rolled-over security that is not fully discharged is extended by the term of the new security; and</p> <p>(c) each notional loan attached to the rolled-over security that is not fully discharged is taken to be attached to the new security.</p>

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-215

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*Consequences if security is not rolled-over*

- (4) If:
- (a) you discharge your obligation under an \*eligible security issued under a \*facility agreement; and
  - (b) the security is not rolled-over at the time of discharge; and
  - (c) you have made a choice for roll-over relief for the facility agreement, and that choice is in effect;
- then, for each notional loan attached to the security, you are taken to have paid a \*foreign currency amount equal to the foreign currency principal amount of the notional loan in order to discharge your obligation to pay the foreign currency principal amount of the notional loan.

*Foreign currency*

- (5) For the purposes of the application of this section to a particular \*facility agreement that provides for the issue of \*eligible securities, **foreign currency** is the \*foreign currency in which the securities are denominated.

Note: Section 960-50 (Australian currency translation rule) does not affect the operation of this section—see subsection 960-50(10). You translate to Australian currency when you apply section 775-215 (forex realisation event 6).

**775-215 Discharge of obligation to pay the principal amount of a notional loan under a facility agreement—forex realisation event 6**

*Forex realisation event 6*

- (1) **Forex realisation event 6** happens if:
- (a) you discharge an obligation, or a part of an obligation, to pay the \*foreign currency principal amount of a notional loan attached to an \*eligible security issued by you under a \*facility agreement; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (b) you have made a choice for roll-over relief for the agreement, and that choice is in effect.

*Time of event*

- (2) The time of the event is when you discharge the obligation or the part of the obligation.

*Forex realisation gain*

- (3) You make a **forex realisation gain** if:
  - (a) the amount of the obligation, or the part of the obligation, at the start time of the notional loan, exceeds the amount you paid in order to discharge the obligation or the part of the obligation; and
  - (b) some or all of the excess is attributable to a \*currency exchange rate effect.

The amount of the **forex realisation gain** is so much of the excess as is attributable to a currency exchange rate effect.

Note: For **currency exchange rate effect**, see section 775-105.

*Forex realisation loss*

- (4) You make a **forex realisation loss** if:
  - (a) the amount of the obligation, or the part of the obligation, at the start time of the notional loan, falls short of the amount you paid in order to discharge the obligation or the part of the obligation; and
  - (b) some or all of the shortfall is attributable to a \*currency exchange rate effect.

The amount of the **forex realisation loss** is so much of the shortfall as is attributable to a currency exchange rate effect.

Note: For **currency exchange rate effect**, see section 775-105.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 775-220

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*Exempt income etc.*

- (5) For the purposes of the application of sections 775-20, 775-25 and 775-35 to the event, assume that the notional loan had been an actual loan.

**775-220 Material variation of a facility agreement—forex realisation event 7**

*Forex realisation event 7*

- (1) **Forex realisation event 7** happens if:
- (a) a material variation is made to the terms or conditions of a \*facility agreement; or
  - (b) a material variation is made to the effect of a facility agreement; or
  - (c) a material variation is made to the type or types of security that can be issued under a facility agreement;
- so long as you have made a choice for roll-over relief for the facility agreement, and that choice is in effect.

Note: See also subsections (7) and (8).

*Time of the event*

- (2) The time of the event is when the material variation happens.

*Forex realisation gain*

- (3) You make a **forex realisation gain** if:
- (a) the total of the forex realisation gains that you would have made as a result of forex realisation event 6 if you had, at the time of forex realisation event 7:
    - (i) discharged your liabilities under each of the notional loans to which the agreement relates; and
    - (ii) not rolled-over any \*eligible security;
- exceeds:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (b) the total of the forex realisation losses that you would have made as a result of forex realisation event 6 if you had, at the time of forex realisation event 7:
  - (i) discharged your liabilities under each of the notional loans to which the agreement relates; and
  - (ii) not rolled-over any eligible security.

The amount of the **forex realisation gain** is the amount of the excess.

Note: See also subsection (9).

*Forex realisation loss*

- (4) You make a **forex realisation loss** if:
  - (a) the total of the forex realisation losses that you would have made as a result of forex realisation event 6 if you had, at the time of forex realisation event 7:
    - (i) discharged your liabilities under each of the notional loans to which the agreement relates; and
    - (ii) not rolled-over any \*eligible security;
  - exceeds:
    - (b) the total of the forex realisation gains that you would have made as a result of forex realisation event 6 if you had, at the time of forex realisation event 7:
      - (i) discharged your liabilities under each of the notional loans to which the agreement relates; and
      - (ii) not rolled-over any eligible security.

The amount of the **forex realisation loss** is the amount of the excess.

Note: See also subsection (9).

*Termination of choice*

- (5) If forex realisation event 7 happens in relation to a \*facility agreement:
  - (a) your choice for roll-over relief for the facility agreement ceases to have effect immediately after the event; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) you are not entitled to make a fresh choice for roll-over relief for the facility agreement.

*Modification of tax recognition time*

- (6) If:
  - (a) forex realisation event 7 happens in relation to a \*facility agreement; and
  - (b) an \*eligible security issued by you under the facility agreement was in existence at the time of that event; and
  - (c) at a later time, forex realisation event 4 happens because you cease to have an obligation, or a part of an obligation, to pay \*foreign currency under the security;

section 775-55 applies to you as if the tax recognition time for the obligation, or the part of the obligation, were the time of forex realisation event 7 (despite subsection 775-55(7)).

*Material variation*

- (7) To avoid doubt, if a variation to:
  - (a) the terms or conditions of a facility agreement; or
  - (b) the effect of a facility agreement;results in the agreement ceasing to be a facility agreement, the variation is taken to be a material variation for the purposes of subsection (1).
- (8) The regulations may provide that a specified kind of variation is taken to be a material variation for the purposes of subsection (1).

*Total amount*

- (9) To avoid doubt, the total amount referred to in paragraph (3)(b) or (4)(b) may be zero.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Subdivision 775-D—Qualifying forex accounts that pass the limited balance test

### Guide to Subdivision 775-D

#### 775-225 What this Subdivision is about

You may elect to have this Subdivision apply to one or more qualifying forex accounts held by you.

If you elect to have this Subdivision apply to an account, a forex realisation gain or a forex realisation loss you make in relation to the account as a result of forex realisation event 2 or 4 is disregarded if the account passes the limited balance test.

For an account to pass the limited balance test, the combined balance of all the accounts covered by your election must not be more than the foreign currency equivalent of \$250,000.

The limited balance test includes a buffer provision which allows the combined balance to be more than the foreign currency equivalent of \$250,000, but not more than the foreign currency equivalent of \$500,000, for not more than 2 15-day periods in any income year.

#### Table of sections

##### Operative provisions

775-230	Election to have this Subdivision apply to one or more qualifying forex accounts
775-235	Variation of election
775-240	Withdrawal of election
775-245	When does a qualifying forex account <i>pass the limited balance test</i> ?
775-250	Tax consequences of passing the limited balance test
775-255	Notional realisation when qualifying forex account starts to pass the limited balance test
775-260	Modification of tax recognition time

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-230

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**Operative provisions**

**775-230 Election to have this Subdivision apply to one or more qualifying forex accounts**

- (1) You may elect to have this Subdivision apply to one or more \*qualifying forex accounts held by you.
  - (2) An election must be in writing.
  - (2A) If:
    - (a) you make an election within 30 days after the commencement of this subsection; and
    - (b) the election is expressed to have come into effect on a specified day; and
    - (c) the specified day is included in the period:
      - (i) beginning on 1 July 2003; and
      - (ii) ending on the day on which the election is made;the election is taken to have come into effect on the specified day.
  - (3) An election continues in effect, in relation to a particular account, until:
    - (a) you cease to hold the account; or
    - (b) the account ceases to be a \*qualifying forex account; or
    - (c) the election is varied by removing the account; or
    - (d) a withdrawal of the election takes effect;whichever happens first.
- Note 1: For variation of election, see section 775-235.
- Note 2: For withdrawal of election, see section 775-240.
- (4) If an election made by you under this section is in effect, you are not entitled to make another election under this section.
  - (5) An \*ADI or a \*non-ADI financial institution is not entitled to make an election under this section.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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### **775-235 Variation of election**

- (1) If you have made an election under section 775-230, you may vary your election by:
  - (a) adding one or more \*qualifying forex accounts; or
  - (b) removing one or more qualifying forex accounts.
- (2) A variation must be in writing.
- (3) Removing an account does not prevent you from adding the account in a future variation.

### **775-240 Withdrawal of election**

- (1) If you have made an election under section 775-230, you may withdraw your election.
- (2) A withdrawal must be in writing.
- (3) Withdrawing an election does not prevent you from making a fresh election under section 775-230 in relation to any or all of the same accounts.

### **775-245 When does a qualifying forex account *pass the limited balance test*?**

#### *Basic rule*

- (1) For the purposes of this Subdivision, a \*qualifying forex account that you hold ***passes the limited balance test*** at a particular time if, at that time:
  - (a) an election made by you under section 775-230 has effect in relation to:
    - (i) the account; or
    - (ii) the account and one or more other \*qualifying forex accounts; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the total of the credit balances of the account and each of those other accounts (if any) is not more than the \*foreign currency equivalent of \$250,000; and
- (c) the total of the debit balances of the account and each of those other accounts (if any) is not more than the foreign currency equivalent of \$250,000.

Note: For buffering during an increased balance period, see subsections (2) and (3).

*Buffering during first and second increased balance period*

- (2) For the purposes of this section, an **increased balance period** is a continuous period consisting of:
  - (a) an income year; or
  - (b) a particular part of an income year;where, at each time during the period, either or both of the following conditions is satisfied:
  - (c) the total of the credit balances of the account or accounts covered by your section 775-230 election is more than the \*foreign currency equivalent of \$250,000, but not more than the foreign currency equivalent of \$500,000;
  - (d) the total of the debit balances of the account or accounts covered by your section 775-230 election is more than the foreign currency equivalent of \$250,000, but not more than the foreign currency equivalent of \$500,000.
- (3) The table has effect:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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<b>Increased balance period</b>		
<b>Item</b>	<b>In this case...</b>	<b>this is the result...</b>
1	<p>(a) an increased balance period is the first or only increased balance period that occurs in a particular income year; and</p> <p>(b) the duration of the period is 15 days or less; and</p> <p>(c) it is not the case that:</p> <p style="padding-left: 20px;">(i) the period began at the start of the income year; and</p> <p style="padding-left: 20px;">(ii) another increased balance period ended at the end of the previous income year</p>	<p>paragraphs (1)(b) and (c) do not apply during the first-mentioned increased balance period.</p>
2	<p>(a) an increased balance period is the first or only increased balance period that occurs in a particular income year; and</p> <p>(b) both:</p> <p style="padding-left: 20px;">(i) the period began at the start of the income year; and</p> <p style="padding-left: 20px;">(ii) another increased balance period ended at the end of the previous income year; and</p> <p>(c) the total duration of those increased balance periods is 15 days or less</p>	<p>paragraphs (1)(b) and (c) do not apply during those increased balance periods.</p>

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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<b>Increased balance period</b>		
<b>Item</b>	<b>In this case...</b>	<b>this is the result...</b>
3	<p>(a) an increased balance period is the first or only increased balance period that occurs in a particular income year; and</p> <p>(b) the duration of the period is more than 15 days; and</p> <p>(c) it is not the case that:</p> <p style="padding-left: 20px;">(i) the period began at the start of the income year; and</p> <p style="padding-left: 20px;">(ii) another increased balance period ended at the end of the previous income year</p>	<p>paragraphs (1)(b) and (c) do not apply during the first 15 days of the first-mentioned increased balance period.</p>
4	<p>(a) an increased balance period is the first or only increased balance period that occurs in a particular income year; and</p> <p>(b) both:</p> <p style="padding-left: 20px;">(i) the period began at the start of the income year; and</p> <p style="padding-left: 20px;">(ii) another increased balance period ended at the end of the previous income year; and</p> <p>(c) the total duration of those increased balance periods is more than 15 days</p>	<p>paragraphs (1)(b) and (c) do not apply during the first 15 days of the period that consists of those increased balance periods.</p>

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

<b>Increased balance period</b>		
<b>Item</b>	<b>In this case...</b>	<b>this is the result...</b>
5	(a) an increased balance period is the second increased balance period that occurs in a particular income year; and (b) the duration of the period is 15 days or less; and (c) item 1 or 2 applies to the first increased balance period that occurred in the income year	paragraphs (1)(b) and (c) do not apply during the first-mentioned increased balance period.
6	(a) an increased balance period is the second increased balance period that occurs in a particular income year; and (b) the duration of the period is more than 15 days; and (c) item 1 or 2 applies to the first increased balance period that occurred in the income year	paragraphs (1)(b) and (c) do not apply during the first 15 days of the first-mentioned increased balance period.

*Translation of foreign currency*

- (4) For the purposes of the application of section 960-50 to this section, work out the \*foreign currency equivalent of an amount of Australian currency as at a particular time in an income year by translating the foreign currency to Australian currency at the average exchange rate for the third month that preceded the income year.

*Debit balances*

- (5) For the purposes of this section, a debit balance is to be expressed as a positive amount.

Note: For example, if you owe \$1,100 on a credit card account, the debit balance of that account is \$1,100.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-250

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**775-250 Tax consequences of passing the limited balance test**

- (1) A \*forex realisation gain or a \*forex realisation loss you make as a result of forex realisation event 2 or 4 is disregarded if the event happens in relation to a \*qualifying forex account that:
  - (a) you hold at the time of the event; and
  - (b) passes the limited balance test at the time of the event.
- (2) If CGT event C1 or C2 happens in relation to a \*qualifying forex account that:
  - (a) you hold at the time of the event; and
  - (b) passes the limited balance test at the time of the event;disregard so much of any \*capital gain or \*capital loss you make as a result of the event as is attributable to a \*currency exchange rate effect.

Note: For *currency exchange rate effect*, see section 775-105.

**775-255 Notional realisation when qualifying forex account starts to pass the limited balance test**

*Credit balance*

- (1) For the purposes of this Division, if:
  - (a) you hold a \*qualifying forex account; and
  - (b) at a particular time:
    - (i) the account starts to pass the limited balance test; and
    - (ii) the account has a credit balance; and
    - (iii) you have one or more rights to receive a total amount of \*foreign currency represented by the credit balance of the account;you are treated as:
  - (c) having ceased to have those rights at that time; and
  - (d) having re-acquired those rights immediately after that time.

Note: This means that forex realisation event 2 will happen when the account starts to pass the limited balance test.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



*Debit balance*

- (2) For the purposes of this Division, if:
- (a) you hold a \*qualifying forex account; and
  - (b) at a particular time:
    - (i) the account starts to pass the limited balance test; and
    - (ii) the account has a debit balance; and
    - (iii) you have one or more obligations to pay a total amount of \*foreign currency represented by the debit balance of the account;
- you are treated as:
- (c) having ceased to have those obligations at that time; and
  - (d) having started to again owe those obligations immediately after that time.

Note: This means that forex realisation event 4 will happen when the account starts to pass the limited balance test.

**775-260 Modification of tax recognition time**

*Forex realisation event 2*

- (1) If:
- (a) forex realisation event 2 happens in relation to a \*qualifying forex account that:
    - (i) you hold at the time of the event; and
    - (ii) does not pass the limited balance test at the time of the event; and
  - (b) apart from this subsection, the tax recognition time, worked out using the table in subsection 775-45(7), happened at a time when the account passed the limited balance test;
- section 775-45 applies to you as if the tax recognition time were the most recent time before the forex realisation event when the account ceased to pass the limited balance test (despite subsection 775-45(7)).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 775-265**

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*Forex realisation event 4*

- (2) If:
- (a) forex realisation event 4 happens in relation to a \*qualifying forex account that:
    - (i) you hold at the time of the event; and
    - (ii) does not pass the limited balance test at the time of the event; and
  - (b) apart from this subsection, the tax recognition time, worked out using the table in subsection 775-55(7), happened at a time when the account passed the limited balance test;
- section 775-55 applies to you as if the tax recognition time were the most recent time before the forex realisation event when the account ceased to pass the limited balance test (despite subsection 775-55(7)).

**Subdivision 775-E—Retranslation for qualifying forex accounts**

**Guide to Subdivision 775-E**

**775-265 What this Subdivision is about**

If you choose retranslation for a qualifying forex account:

- (a) a forex realisation gain or a forex realisation loss you make in relation to the account as a result of forex realisation event 2 or 4 is disregarded; and
- (b) forex realisation event 8 enables any gains or losses to be worked out on a retranslation basis.

**Table of sections**

**Operative provisions**

775-270 You may choose retranslation for a qualifying forex account

775-275 Withdrawal of choice

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- 775-280 Tax consequences of choosing retranslation for an account  
775-285 Retranslation of gains and losses relating to a qualifying forex account—  
forex realisation event 8

## Operative provisions

### 775-270 You may choose retranslation for a qualifying forex account

- (1) You may choose retranslation for a \*qualifying forex account held by you.
- (1A) A choice under subsection (1) does not apply to a \*qualifying forex account held by you if a \*foreign exchange retranslation election by you is in effect in relation to the account under Subdivision 230-D.
- (2) A choice must be in writing.
- (2A) If:
  - (a) either:
    - (i) you make a choice within 30 days after the commencement of the *New Business Tax System (Taxation of Financial Arrangements) Act (No. 1) 2003*; or
    - (ii) you make a choice within 90 days after the commencement of Part 1 of Schedule 1 to the *Tax Laws Amendment (Taxation of Financial Arrangements) Act 2009*; and
  - (b) the choice is expressed to have come into effect on a specified day; and
  - (c) the specified day is included in the period:
    - (i) beginning on 1 July 2003; and
    - (ii) ending on the day on which the choice is made;the choice is taken to have come into effect on the specified day.
- (3) A choice continues in effect until:
  - (a) you cease to hold the account; or
  - (b) the account ceases to be a \*qualifying forex account; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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(c) a withdrawal of the choice takes effect;  
whichever happens first.

Note: For withdrawal of choice, see section 775-275.

**775-275 Withdrawal of choice**

- (1) If you have made a choice for retranslation for a \*qualifying forex account held by you, you may withdraw your choice.
- (2) A withdrawal must be in writing.
- (3) Withdrawing a choice does not prevent you from making a fresh choice under section 775-270.

**775-280 Tax consequences of choosing retranslation for an account**

- (1) A \*forex realisation gain or \*forex realisation loss you make as a result of forex realisation event 2 or 4 is disregarded if:
  - (a) the event happens in relation to a \*qualifying forex account that you hold; and
  - (b) you have made a choice for retranslation for the account; and
  - (c) the choice is in effect when the event happens.
- (2) If:
  - (a) CGT event C1 or C2 happens in relation to a \*qualifying forex account that you hold at the time of the event; and
  - (b) you have made a choice for retranslation for the account; and
  - (c) the choice is in effect when the event happens;disregard so much of any \*capital gain or \*capital loss you make as a result of the event as is attributable to a \*currency exchange rate effect.

Note: For *currency exchange rate effect*, see section 775-105.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**775-285 Retranslation of gains and losses relating to a qualifying forex account—forex realisation event 8**

*Forex realisation event 8*

- (1) **Forex realisation event 8** happens if:
- (a) you have made a choice for retranslation for a <sup>\*</sup>qualifying forex account held by you; and
  - (b) that choice was in effect throughout a continuous period (the **retranslation period**) consisting of:
    - (i) an income year; or
    - (ii) a particular part of an income year; and
  - (c) either:
    - (i) there is a positive retranslation amount for the account for the retranslation period (worked out under subsection (2)); or
    - (ii) there is a negative retranslation amount for the account for the retranslation period (worked out under subsection (3)).

*Retranslation amount*

- (2) If the amount worked out using the formula in subsection (4) is a positive amount, that amount is a **positive retranslation amount** for the account for the retranslation period.
- (3) If the amount worked out using the formula in subsection (4) is a negative amount, that amount is a **negative retranslation amount** for the account for the retranslation period.
- (4) Work out an amount for the account for the retranslation period using the formula:

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<sup>\*</sup>To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Closing balance of account for the retranslation period	–	Opening balance of account for the retranslation period	–	Total deposits made to account during the retranslation period	+	Total withdrawals made from account during the retranslation period
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- (5) For the purposes of subsection (4), a debit balance is to be expressed as a negative amount (for example, a debit balance of \$50,000 is to be expressed as – \$50,000).

*Forex realisation gain*

- (6) You make a **forex realisation gain** if there is a positive retranslation amount for the account for the retranslation period. The amount of the **forex realisation gain** is the positive retranslation amount.

*Forex realisation loss*

- (7) You make a **forex realisation loss** if there is a negative retranslation amount for the account for the retranslation period. The amount of the **forex realisation loss** is the negative retranslation amount.
- (8) For the purposes of subsection (7), reverse a negative amount (for example, a negative retranslation amount of – \$50,000 will become a forex realisation loss of \$50,000).

*Translation of foreign currency*

- (9) For the purposes of the application of section 960-50 to this section:
- (a) if a retranslation period for an account did not begin immediately after the end of another retranslation period for the account—the opening balance of the account for the first-mentioned retranslation period is to be translated to

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Australian currency at the exchange rate applicable at the start of the first-mentioned retranslation period; and

- (b) if a retranslation period for an account began immediately after the end of another retranslation period for the account—the opening balance of the account for the first-mentioned retranslation period is to be translated to Australian currency at the exchange rate applicable at the end of the other retranslation period; and
- (c) the closing balance of an account for a retranslation period is to be translated to Australian currency at the exchange rate applicable at the end of the retranslation period; and
- (d) each deposit is to be translated to Australian currency at the exchange rate applicable at the time of the deposit; and
- (e) each withdrawal is to be translated to Australian currency at the exchange rate applicable at the time of the withdrawal.

*Deposits*

- (10) For the purposes of this section, a **deposit** includes any amount paid or transferred into the account.

*Withdrawals*

- (11) For the purposes of this section, a **withdrawal** includes any amount paid, advanced, drawn or transferred out of the account.

**Subdivision 775-F—Retranslation under foreign exchange  
retranslation election under Subdivision 230-D**

**Guide to Subdivision 775-F**

**775-290 What this Subdivision is about**

If you have made a foreign exchange retranslation election under Subdivision 230-D:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) a forex realisation gain or a forex realisation loss you make in relation to an arrangement that is not a Division 230 financial arrangement as a result of forex realisation event 1 to 5 or 8 is disregarded; and
- (b) forex realisation event 9 enables any gains or losses to be worked out on a retranslation basis.

**Table of sections**

775-295	When this Subdivision applies
775-300	Tax consequences of choosing retranslation for arrangement
775-305	Retranslation of gains and losses relating to arrangement to which foreign exchange retranslation election applies—forex realisation event 9
775-310	When election ceases to apply to arrangement
775-315	Balancing adjustment when election ceases to apply to arrangement

**775-295 When this Subdivision applies**

- (1) A \*foreign exchange retranslation election applies to an \*arrangement for the purposes of this Subdivision if:
  - (a) you start to have the arrangement after the start of the income year in which the election is made; and
  - (b) the arrangement is recognised in financial reports of a kind referred to in paragraph 230-255(2)(a) that are audited, or required to be audited, as referred to in paragraph 230-255(2)(b); and
  - (c) the arrangement is one in relation to which you are required by:
    - (i) \*accounting standard AASB 121 (or another accounting standard prescribed for the purposes of paragraph 230-265(1)(c)); or
    - (ii) if that standard does not apply to the preparation of the financial report—a comparable accounting standard that applies to the preparation of the financial report under a \*foreign law;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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to recognise, in the financial reports referred to in paragraph 230-255(2)(a), amounts in profit or loss (if any) that are attributable to changes in currency exchange rates.

- (2) The \*foreign exchange retranslation election does not apply to an \*arrangement for the purposes of this Subdivision if:
- (a) the election is made by the \*head company of a \*consolidated group or \*MEC group; and
  - (b) the election specifies that the election is not to apply to \*financial arrangements in relation to \*life insurance business carried on by a member of the consolidated group or MEC group; and
  - (c) the arrangement is one that relates to the life insurance business carried on by a member of the consolidated group or MEC group.
- (3) The \*foreign exchange retranslation election does not apply to an \*arrangement for the purposes of this Subdivision if the arrangement is associated with a business of a kind specified in regulations made for the purposes of subsection 230-270(4).

### **775-300 Tax consequences of choosing retranslation for arrangement**

- (1) A \*forex realisation gain or \*forex realisation loss you make as a result of forex realisation event 1, 2, 3, 4, 5 or 8 is disregarded if:
- (a) the event happens in relation to an \*arrangement that you hold; and
  - (b) you have made a \*foreign exchange retranslation election that applies to the arrangement; and
  - (c) the election is in effect when the event happens.
- (2) If:
- (a) CGT event C1 or C2 happens in relation to an \*arrangement that you hold at the time of the event; and
  - (b) you have made a \*foreign exchange retranslation election that applies to the arrangement; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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(c) the election is in effect when the event happens;  
disregard so much of any \*capital gain or \*capital loss you make as  
a result of the event as is attributable to a \*currency exchange rate  
effect.

Note: For *currency exchange rate effect*, see section 775-105.

**775-305 Retranslation of gains and losses relating to arrangement to  
which foreign exchange retranslation election applies—  
forex realisation event 9**

*Forex realisation event 9*

- (1) **Forex realisation event 9** happens in relation to an \*arrangement  
during an income year if:
- (a) you have made a \*foreign exchange retranslation election that  
applies to the arrangement; and
  - (b) you are required by:
    - (i) \*accounting standard AASB 121 (or another accounting  
standard prescribed for the purposes of  
paragraph 230-265(1)(c)); or
    - (ii) if that standard does not apply to the preparation of the  
financial report—a comparable accounting standard that  
applies to the preparation of the financial report under a  
\*foreign law;
- to recognise, in the financial report referred to in  
paragraph 230-255(2)(a) for that income year, amounts in  
profit or loss (if any) in relation to the arrangement that are  
attributable to changes in currency exchange rates.

The **forex realisation event 9** is taken to have happened in the  
income year.

*Forex realisation gain*

- (2) You make a **forex realisation gain** if the standard referred to in  
paragraph (1)(b) requires you to recognise an amount of gain in  
profit or loss in relation to the \*arrangement. That amount of the

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 775-310

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**forex realisation gain** is the amount the standard requires you to recognise.

*Forex realisation loss*

- (3) You make a **forex realisation loss** if the \*accounting standard referred to in paragraph (1)(b) requires you to recognise an amount of loss in profit or loss in relation to the \*arrangement. That amount of the **forex realisation loss** is the amount that the accounting standard requires you to recognise.

*Section does not apply to amounts previously recognised in equity*

- (4) Subsections (1), (2) and (3) do not apply to amounts that have previously been required by the standards referred to in paragraph 230-255(2)(a) to be recognised in equity.

**775-310 When election ceases to apply to arrangement**

- (1) For the purposes of this Division, a \*foreign exchange retranslation election under subsection 230-255(1) ceases to apply to an \*arrangement from the start of an income year if the arrangement ceases to satisfy a requirement of paragraph 775-295(1)(b) or (c) during that income year.
- (2) If the election ceases to apply to an \*arrangement under subsection (1), the election cannot subsequently reapply to that arrangement (even if the requirements of paragraphs 775-295(1)(b) and (c) are satisfied once more in relation to the arrangement).

**775-315 Balancing adjustment when election ceases to apply to arrangement**

- (1) This section applies if:
- (a) you make a \*foreign exchange retranslation election; and
  - (b) the election ceases to have effect or ceases to apply to an \*arrangement.
- (2) You are taken, for the purposes of this Division, to have:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) disposed of the \*arrangement for its fair value immediately before the election ceases to have effect or ceases to apply to the arrangement; and
- (b) reacquired the arrangement at its fair value immediately after the election ceases to have effect or ceases to apply to the arrangement.

Note: Paragraph (a) means that there would be a forex realisation event 9 in relation to the arrangement.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Division 802—Foreign residents' income with an underlying foreign source**

### **Table of Subdivisions**

802-A Conduit foreign income

### **Subdivision 802-A—Conduit foreign income**

### **Guide to Subdivision 802-A**

#### **802-5 What this Subdivision is about**

A distribution that an Australian corporate tax entity makes to a foreign resident is not subject to dividend withholding tax, and is not assessable income, to the extent that the entity declares it to be conduit foreign income.

An Australian corporate tax entity has an amount that is non-assessable non-exempt income if it receives a distribution including conduit foreign income from another such entity and it makes a distribution including conduit foreign income.

This Subdivision sets out the method of working out an entity's conduit foreign income.

It also discourages streaming of distributions to entities that can take advantage of the receipt of conduit foreign income.

### **Table of sections**

#### **Operative provisions**

802-10	Objects
802-15	Foreign residents—exempting CFI from Australian tax
802-17	Trust estates and foreign resident beneficiaries—exempting CFI from Australian tax

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 802-10**

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802-20	Distributions between Australian corporate tax entities—non-assessable non-exempt income
802-25	Conduit foreign income of an Australian corporate tax entity
802-30	Foreign source income amounts
802-35	Capital gains and losses
802-40	Effect of foreign income tax offset on conduit foreign income
802-45	Previous declarations of conduit foreign income
802-50	Receipt of an unfranked distribution from another Australian corporate tax entity
802-55	No double benefits
802-60	No streaming of distributions

**Operative provisions**

**802-10 Objects**

The objects of this Subdivision are:

- (a) to encourage the establishment in Australia of regional holding companies for foreign groups; and
- (b) to improve Australia's attractiveness as a continuing base for its multinational companies;

by providing relief from tax on \*distributions by \*Australian corporate tax entities to \*members who are foreign residents or other Australian corporate tax entities if those distributions relate to \*conduit foreign income.

**802-15 Foreign residents—exempting CFI from Australian tax**

- (1) So much of the \*unfranked part of a \*frankable distribution made by an \*Australian corporate tax entity that the entity declares, in its \*distribution statement, to be \*conduit foreign income:
  - (a) is not assessable income and is not \*exempt income of a foreign resident; and
  - (b) is an amount to which section 128B (Liability to withholding tax) of the *Income Tax Assessment Act 1936* does not apply.
- (2) The declaration must be made on or before the day on which the \*distribution is made.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Note: For a private company, this rule may bring forward the time at which the company is required to make its distribution statement: see section 202-75.

### **802-17 Trust estates and foreign resident beneficiaries—exempting CFI from Australian tax**

#### *Foreign resident beneficiaries*

- (1) So much of a share of the net income of a trust as is reasonably attributable to the whole or a part of the \*unfranked part of a \*frankable distribution made by an \*Australian corporate tax entity that the entity declares, in its \*distribution statement, to be \*conduit foreign income:
  - (a) is not assessable income and is not \*exempt income of a beneficiary of the trust who:
    - (i) is a foreign resident; and
    - (ii) is presently entitled to the share of the income of the trust; and
  - (b) is an amount to which section 128B (Liability to withholding tax) of the *Income Tax Assessment Act 1936* does not apply.

Note: A frankable distribution to which a part of the net income of a trust is reasonably attributable may be made by the Australian corporate tax entity to the trust directly, or to the trust indirectly through one or more interposed trusts.

- (2) The declaration must be made on or before the day on which the \*distribution is made.

Note: For a private company, this rule may bring forward the time at which the company is required to make its distribution statement: see section 202-75.

#### *Trusts*

- (3) The trustee of a trust is not to be assessed (and pay tax) under section 98, 99 or 99A of the *Income Tax Assessment Act 1936* in respect of so much of the net income of the trust as is

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 802-20

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\*non-assessable non-exempt income of a beneficiary of the trust under subsection (1).

**802-20 Distributions between Australian corporate tax entities—  
non-assessable non-exempt income**

- (1) An \*Australian corporate tax entity (the **receiving entity**) has an amount that is not assessable income and is not \*exempt income for an income year if:
- (a) it receives from another Australian corporate tax entity a \*frankable distribution that has an \*unfranked part; and
  - (b) the \*distribution statement for the \*distribution declares an amount (a **received CFI amount**) of the unfranked part to be \*conduit foreign income; and
  - (c) the receiving entity, after the start of the income year but before the due day for lodging its \*income tax return for that income year:
    - (i) makes a frankable distribution that has an unfranked part; and
    - (ii) declares an amount (a **declared CFI amount**) of the unfranked part to be conduit foreign income.
- (2) The amount that is not assessable income and is not \*exempt income is the lesser of:
- (a) the sum of the received CFI amounts that the receiving entity receives during the income year (the **total received CFI amounts**); and
  - (b) the amount worked out using this formula:

$$\text{Total received CFI amounts} \times \frac{\text{Total declared CFI amounts}}{\text{Total received CFI amounts} - \text{Related expenses}}$$

where:

**related expenses** means the receiving entity's expenses that are reasonably related to the total received CFI amounts.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



***total declared CFI amounts*** means the sum of the declared CFI amounts in distributions made by the receiving entity before the due day for lodging its \*income tax return for the income year.

Example: AusCo 1 and AusCo 2 are both Australian corporate tax entities.

AusCo 1 pays an unfranked dividend of \$80 to AusCo 2. AusCo 1 declares all of the \$80 to be its conduit foreign income (so the \$80 is a received CFI amount).

AusCo 2 has \$5 of deductible expenses relating to the \$80 dividend.

AusCo 2 pays an unfranked dividend of \$30. AusCo 2 declares \$15 of the \$30 to be conduit foreign income (so the \$15 is a declared CFI amount).

The amount that is not assessable income and is not exempt income for AusCo 2 (assuming there are no other received CFI amounts or declared CFI amounts) is:

$$\$80 \times \frac{\$15}{\$75} = \$16$$

The remaining \$64 is included in AusCo 2's assessable income and it can deduct \$4 (the part of the expenses related to the \$64).

- (3) If the receiving entity's expenses that are reasonably related to the total received CFI amounts equal or exceed the total received CFI amounts for an income year, the total received CFI amounts is not assessable income and is not \*exempt income of the receiving entity for the income year.
- (4) If a declared CFI amount is taken into account in working out an amount of \*non-assessable non-exempt income of an entity for an income year, that amount cannot be taken into account for the entity for a later income year.
- (5) Work out how much \*conduit foreign income in a \*frankable distribution flows through a trust or a partnership in the same way that you work out the \*share of a \*franking credit on a \*franked distribution that flows through a trust or a partnership. That amount is treated as a received CFI amount under this section.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 802-25

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Note: See sections 207-50, 207-55 and 207-57 for the share of a franking credit on a franked distribution that flows through a trust or a partnership.

### 802-25 Conduit foreign income of an Australian corporate tax entity

An \*Australian corporate tax entity's **conduit foreign income** at a particular time (the **relevant time**) is worked out by applying sections 802-30 to 802-55.

Note: Subdivision 715-U modifies the single entity and the entry history rule for the purposes of working out conduit foreign income for consolidated groups and MEC groups.

### 802-30 Foreign source income amounts

- (1) Work out the amount of the entity's \*ordinary income and \*statutory income derived by the entity that has been, is or will be included in an income statement or similar statement of the entity or of another entity and that would not be included in the entity's assessable income if the entity:
  - (a) for a company or a \*corporate limited partnership—were a foreign resident at the relevant time; or
  - (b) for a \*public trading trust—were not a \*resident unit trust for the income year in which the relevant time occurs.

Note: Income statements are prepared under the Framework for the Preparation and Presentation of Financial Statements (which is referred to in the Australian Accounting Standards).

- (2) Reduce the subsection (1) amount by any part of that amount that is or will be included in the entity's assessable income (apart from section 802-20).
- (3) Add to the amount remaining after subsection (2) these amounts:
  - (a) if the entity receives from another \*Australian corporate tax entity a \*frankable distribution that has an \*unfranked part—any amount declared in the \*distribution statement for that \*distribution to be \*conduit foreign income;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (b) an amount that is treated as a received CFI amount for the purposes of section 802-20 because of subsection 802-20(5);
  - (c) an amount that is \*non-assessable non-exempt income under section 768-5 and that would be not be included under subsection (1).
- (4) Reduce the amount remaining after subsection (3) by these amounts:
- (a) an amount that is \*non-assessable non-exempt income under section 23AI or 23AK of the *Income Tax Assessment Act 1936*;
  - (b) an amount that is not included in the entity's assessable income because of the operation of paragraph 99B(2)(e) of that Act;
  - (c) the amount worked out using the formula:

$$\text{Available franking credit} \times \frac{(1 - \text{*Corporate tax rate})}{\text{*Corporate tax rate}}$$

where:

***available franking credit*** means any part of the amount remaining after subsection (3) to the extent to which a \*franking credit arises or will arise for the entity.

- (5) Reduce the amount remaining after subsection (4) by any of the entity's expenses that are reasonably related to that amount, except expenses the entity has deducted or can deduct under this Act. In applying this subsection to an amount covered by paragraph (3)(a), assume that amount is \*non-assessable non-exempt income.
- (6) The result is an amount included in the entity's ***conduit foreign income***.
- (7) This section applies to an entity as if it had derived an amount if the amount has been applied for its benefit (including by discharging all or part of a debt it owes) or as it directs.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 802-35

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**802-35 Capital gains and losses**

*Capital gains*

- (1) The entity's **conduit foreign income** includes these amounts:
- (a) the amount by which a \*capital gain of the entity is reduced because of the operation of section 768-505;
  - (b) a capital gain that is disregarded because of the operation of subsection 23AH(3) of the *Income Tax Assessment Act 1936*;
  - (c) the amount of a capital gain that is disregarded as a result of the operation of an \*international tax sharing treaty.

*Capital losses*

- (2) The entity's **conduit foreign income** is reduced by these amounts:
- (a) the amount by which a \*capital loss of the entity is reduced because of the operation of section 768-505;
  - (b) a capital loss that is disregarded because of the operation of subsection 23AH(4) of the *Income Tax Assessment Act 1936*;
  - (c) the amount of a capital loss that is disregarded as a result of the operation of an \*international tax sharing treaty.

*Timing rule*

- (3) The adjustments are made under this section at the end of the income year in which the \*CGT event occurred.

**802-40 Effect of foreign income tax offset on conduit foreign income**

The entity's **conduit foreign income** includes an amount if a tax offset arose for the entity under Division 770 for the income year immediately before the one in which the relevant time occurs. The amount is worked out using the formula:

$$\text{Offset} \times \frac{(1 - \text{*Corporate tax rate})}{\text{*Corporate tax rate}}$$

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

### **802-45 Previous declarations of conduit foreign income**

The entity's *conduit foreign income* is reduced if:

- (a) the entity makes a \*frankable distribution that has an \*unfranked part; and
- (b) the entity declares an amount of the unfranked part to be conduit foreign income.

The amount of the reduction is the amount so declared.

Note: If the amount declared is less than the amount available for declaration, the difference is available for a later declaration.

### **802-50 Receipt of an unfranked distribution from another Australian corporate tax entity**

- (1) The entity's *conduit foreign income* is reduced if:
  - (a) the entity (the *receiving entity*) receives from another \*Australian corporate tax entity a \*frankable distribution that has an \*unfranked part; and
  - (b) the \*distribution statement for the \*distribution declares an amount (the *declared amount*) of the unfranked part to be conduit foreign income; and
  - (c) some or all of the declared amount is not \*non-assessable non-exempt income under section 802-20.
- (2) The amount of the reduction is the amount that is not \*non-assessable non-exempt income under section 802-20 less any expenses reasonably related to that amount.

### **802-55 No double benefits**

An amount cannot be both:

- (a) an unfranked non-portfolio dividend credit for an entity under section 46FB of the *Income Tax Assessment Act 1936*; and
- (b) counted towards:
  - (i) the entity's \*conduit foreign income; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 802-60

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- (ii) the entity's \*non-assessable non-exempt income under section 802-20.

**802-60 No streaming of distributions**

- (1) Subsection (2) has effect if:
- (a) an \*Australian corporate tax entity makes one or more \*frankable distributions in a \*franking period; and
  - (b) at least one of the \*distributions has an \*unfranked part; and
  - (c) the entity declares an amount of the unfranked part to be \*conduit foreign income.
- (2) If the entity does not, for that \*franking period, declare the same proportion of \*conduit foreign income for all \*membership interests and \*non-share equity interests then, instead of the amount that it declared to be conduit foreign income on those \*distributions, it is taken to have declared under section 802-45 the greater amount that it would have declared had it declared that same proportion on all those distributions.

Note: Breaching subsection (2) may make the entity subject to a penalty under section 288-80 in Schedule 1 to the *Taxation Administration Act 1953* (about over declaring conduit foreign income).

Example: There are 10,000 membership interests in AusCo Limited, 7,500 held by foreign residents and 2,500 held by Australian residents. It has \$1,800 of conduit foreign income.

AusCo makes an unfranked distribution of 50 cents per membership interest to all of its members. It declares \$1,500 of the distribution to be conduit foreign income for its 7,500 foreign membership interests (20 cents per membership interest or 40% of each distribution) and none for its Australian membership interests.

AusCo is taken to have declared the same proportion (40% of each distribution) of conduit foreign income for its Australian membership interests (which amounts to \$500 of conduit foreign income). It is therefore taken to have declared \$2,000 of conduit foreign income. This is an over-declaration of \$200 and a penalty under section 288-80 in Schedule 1 to the *Taxation Administration Act 1953* will apply.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (3) For the purposes of subsection (2), ignore \*membership interests and \*non-share equity interests that do not carry a right to receive \*distributions (other than distributions on winding up).
- (4) Despite subsection (2), an entity that receives a \*frankable distribution that has an \*unfranked part is entitled to rely on the \*distribution statement made by the entity that made the distribution.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Division 815—Cross-border transfer pricing

### Table of Subdivisions

815-A	Treaty-equivalent cross-border transfer pricing rules
815-B	Arm's length principle for cross-border conditions between entities
815-C	Arm's length principle for permanent establishments
815-D	Special rules for trusts and partnerships
815-E	Reporting obligations for country by country reporting entities

### Subdivision 815-A—Treaty-equivalent cross-border transfer pricing rules

#### Guide to Subdivision 815-A

##### 815-1 What this Subdivision is about

The cross-border transfer pricing rules in this Subdivision are equivalent to, but independent of, the transfer pricing rules in Australia's double tax agreements.

### Table of sections

#### Operative provisions

815-5	Object
815-10	Transfer pricing benefit may be negated
815-15	When an entity gets a <i>transfer pricing benefit</i>
815-20	Cross-border transfer pricing guidance
815-25	Modified transfer pricing benefit for thin capitalisation
815-30	Determinations negating transfer pricing benefit
815-35	Consequential adjustments
815-40	No double taxation

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Operative provisions

### 815-5 Object

The object of this Subdivision is to ensure the following amounts are appropriately brought to tax in Australia, consistent with the arm's length principle:

- (a) profits which would have accrued to an Australian entity if it had been dealing at \*arm's length, but, by reason of non-arm's length conditions operating between the entity and its foreign associated entities, have not so accrued;
- (b) profits which an Australian permanent establishment (within the meaning of the relevant \*international tax agreement) of a foreign entity might have been expected to make if it were a distinct and separate entity engaged in the same or similar activities under the same or similar conditions, but dealing wholly independently.

### 815-10 Transfer pricing benefit may be negated

- (1) The Commissioner may make a determination mentioned in subsection 815-30(1), in writing, for the purpose of negating a \*transfer pricing benefit an entity gets.

#### *Treaty requirement*

- (2) However, this section only applies to an entity if:
  - (a) the entity gets the \*transfer pricing benefit under subsection 815-15(1) at a time when an \*international tax agreement containing an \*associated enterprises article applies to the entity; or
  - (b) the entity gets the transfer pricing benefit under subsection 815-15(2) at a time when an international tax agreement containing a \*business profits article applies to the entity.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 815-15

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Note: This Subdivision does not apply to income years to which Subdivisions 815-B and 815-C apply: see section 815-1 of the *Income Tax (Transitional Provisions) Act 1997*.

**815-15 When an entity gets a *transfer pricing benefit***

*Transfer pricing benefit—associated enterprises*

- (1) An entity gets a ***transfer pricing benefit*** if:
- (a) the entity is an Australian resident; and
  - (b) the requirements in the \*associated enterprises article for the application of that article to the entity are met; and
  - (c) an amount of profits which, but for the conditions mentioned in the article, might have been expected to accrue to the entity, has, by reason of those conditions, not so accrued; and
  - (d) had that amount of profits so accrued to the entity:
    - (i) the amount of the taxable income of the entity for an income year would be *greater* than its actual amount; or
    - (ii) the amount of a tax loss of the entity for an income year would be *less* than its actual amount; or
    - (iii) the amount of a \*net capital loss of the entity for an income year would be *less* than its actual amount.

The amount of the ***transfer pricing benefit*** is the difference between the amounts mentioned in subparagraph (d)(i), (ii) or (iii) (as the case requires).

*Transfer pricing benefit—business profits*

- (2) A foreign resident entity gets a ***transfer pricing benefit*** if:
- (a) the entity has a permanent establishment (within the meaning of the \*international tax agreement) in Australia; and
  - (b) the amount of profits attributed to the permanent establishment falls short of the amount of profits the permanent establishment might be expected to make if it were a distinct and separate entity engaged, and dealing, in the manner mentioned in the \*business profits article; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (c) had the profits attributed to the permanent establishment included that shortfall:
- (i) the amount of the taxable income of the entity for an income year would be *greater* than its actual amount; or
  - (ii) the amount of a tax loss of the entity for an income year would be *less* than its actual amount; or
  - (iii) the amount of a \*net capital loss of the entity for an income year would be *less* than its actual amount.

The amount of the ***transfer pricing benefit*** is the difference between the amounts mentioned in subparagraph (c)(i), (ii) or (iii) (as the case requires).

*Nil amounts*

- (3) For the purposes of working out whether an entity gets a \*transfer pricing benefit, and of negating that benefit under subsection 815-30(1):
- (a) treat an entity that has no taxable income for an income year as having a taxable income for the year of a nil amount; and
  - (b) treat an entity that has no tax loss for an income year as having a tax loss for the year of a nil amount; and
  - (c) treat an entity that has no \*net capital loss for an income year as having a net capital loss for the year of a nil amount.

*Multiple transfer pricing benefits*

- (4) To avoid doubt, an entity may get 2 or more \*transfer pricing benefits, in one or more income years, in relation to one amount of profits, or one shortfall of profits.

*Meaning of associated enterprises article*

- (5) An ***associated enterprises article*** is:
- (a) Article 9 of the United Kingdom convention (within the meaning of the *International Tax Agreements Act 1953*); or
  - (b) a corresponding provision of another \*international tax agreement.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 815-20

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*Meaning of business profits article*

- (6) A **business profits article** is:
- (a) Article 7 of the United Kingdom convention (within the meaning of the *International Tax Agreements Act 1953*); or
  - (b) a corresponding provision of another \*international tax agreement.

**815-20 Cross-border transfer pricing guidance**

- (1) For the purpose of determining the effect this Subdivision has in relation to an entity:
- (a) work out whether an entity gets a \*transfer pricing benefit consistently with the documents covered by this section, to the extent the documents are relevant; and
  - (b) interpret a provision of an \*international tax agreement consistently with those documents, to the extent they are relevant.
- (2) The documents covered by this section are as follows:
- (a) the Model Tax Convention on Income and on Capital, and its Commentaries, as adopted by the Council of the Organisation for Economic Cooperation and Development and last amended on 22 July 2010;
  - (b) the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, as approved by that Council and last amended on 22 July 2010;
  - (c) a document, or part of a document, prescribed by the regulations for the purposes of this paragraph.
- (3) However, a document, or a part of a document, mentioned in paragraph (2)(a) or (b) is not covered by this section if the regulations so prescribe.
- (4) Regulations made for the purposes of paragraph (2)(c) or subsection (3) may prescribe different documents or parts of documents for different circumstances.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**815-25 Modified transfer pricing benefit for thin capitalisation**

- (1) This section modifies the \*transfer pricing benefit an entity gets, or apart from this section would get, in an income year if:
  - (a) Division 820 (about thin capitalisation) applies to the entity for the income year; and
  - (b) the transfer pricing benefit relates to profits, or a shortfall of profits, referable to costs that are \*debt deductions of the entity for the income year.
- (2) If working out what those costs might have been, or might be expected to be, involves applying a rate to a \*debt interest:
  - (a) work out the rate by applying section 815-15, having regard to section 815-20; but
  - (b) apply the rate to the debt interest the entity actually issued.

Note: Division 820 may apply to further reduce debt deductions.

**815-30 Determinations negating transfer pricing benefit**

- (1) The determinations the Commissioner may make are as follows:
  - (a) a determination of an amount by which the taxable income of the entity for an income year is increased;
  - (b) a determination of an amount by which the tax loss of the entity for an income year is decreased;
  - (c) a determination of an amount by which the \*net capital loss of the entity for an income year is decreased.
- (2) If the Commissioner makes a determination under subsection (1), the determination is taken to be attributable, to the relevant extent, to such of the following as the Commissioner may determine:
  - (a) an increase of a particular amount in assessable income of the entity for an income year under a particular provision of this Act;
  - (b) a decrease of a particular amount in particular deductions of the entity for an income year;
  - (c) an increase of a particular amount in particular capital gains of the entity for an income year;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 815-35

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- (d) a decrease of a particular amount in particular capital losses of the entity for an income year.
- (3) If the Commissioner makes a determination under subsection (1), the Commissioner must make a determination under subsection (2), unless it is not possible or practicable for the Commissioner to do so.

Example: If section 815-25 is relevant in working out the transfer pricing benefit an entity gets, this subsection requires the Commissioner to make a determination relating to the debt deductions of the entity.
- (4) Nothing done under subsection (2) affects the validity of a determination made under subsection (1).
- (5) The Commissioner may take such action as the Commissioner considers necessary to give effect to a determination under this section.
- (6) The Commissioner must give a copy of a determination under this section to the entity.
- (7) A failure to comply with subsection (6) does not affect the validity of the determination.

### 815-35 Consequential adjustments

*Consequential adjustment—associated enterprises*

- (1) The Commissioner may make a determination under subsection (4) in relation to an entity (the **disadvantaged entity**) if:
  - (a) the Commissioner makes a determination under subsection 815-30(1) in relation to a \*transfer pricing benefit an entity gets under subsection 815-15(1); and
  - (b) the Commissioner considers that, but for the conditions mentioned in the \*associated enterprises article:
    - (i) the amount of the taxable income of the disadvantaged entity for an income year might have been expected to be *less* than its actual amount; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) the amount of a \*tax loss of the disadvantaged entity for an income year might have been expected to be *greater* than its actual amount; or
  - (iii) the amount of a \*net capital loss of the disadvantaged entity for an income year might have been expected to be *greater* than its actual amount; or
  - (iv) an amount of \*withholding tax payable in respect of interest or royalties by the disadvantaged entity might have been expected to be *less* than its actual amount; and
- (c) the Commissioner considers that it is fair and reasonable that the actual amount mentioned in subparagraph (b)(i), (ii), (iii) or (iv) (as the case requires) be adjusted accordingly.

*Consequential adjustment—business profits*

- (2) The Commissioner may make a determination under subsection (4) in relation to an entity (the ***disadvantaged entity***) if:
- (a) the Commissioner makes a determination under subsection 815-30(1) in relation to a \*transfer pricing benefit an entity gets under subsection 815-15(2); and
  - (b) the Commissioner considers that, if the permanent establishment were a distinct and separate entity engaged, and dealing, in the manner mentioned in the \*business profits article:
    - (i) the amount of the taxable income of the disadvantaged entity for an income year might have been expected to be *less* than its actual amount; or
    - (ii) the amount of a \*tax loss of the disadvantaged entity for an income year might have been expected to be *greater* than its actual amount; or
    - (iii) the amount of a \*net capital loss of the disadvantaged entity for an income year might have been expected to be *greater* than its actual amount; or
    - (iv) an amount of \*withholding tax payable in respect of interest or royalties by the disadvantaged entity might

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 815-35

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have been expected to be *less* than its actual amount;  
and

- (c) the Commissioner considers that it is fair and reasonable that the actual amount mentioned in subparagraph (b)(i), (ii), (iii) or (iv) (as the case requires) be adjusted accordingly.

*Nil amounts*

- (3) For the purposes of this section:
- (a) treat an entity that has no taxable income for an income year as having a taxable income for the year of a nil amount; and
  - (b) treat an entity that has no tax loss for an income year as having a tax loss for the year of a nil amount; and
  - (c) treat an entity that has no <sup>\*</sup>net capital loss for an income year as having a net capital loss for the year of a nil amount.

*Consequential adjustment—determinations*

- (4) The Commissioner may make one or more of the following determinations, in writing, for the purpose of adjusting an amount as mentioned in paragraph (1)(c) or (2)(c):
- (a) a determination of an amount by which the taxable income of the disadvantaged entity for an income year is decreased;
  - (b) a determination of an amount by which the tax loss of the disadvantaged entity for an income year is increased;
  - (c) a determination of an amount by which the <sup>\*</sup>net capital loss of the disadvantaged entity for an income year is increased;
  - (d) a determination of an amount by which the <sup>\*</sup>withholding tax payable by the disadvantaged entity in respect of interest or royalties is decreased.
- (5) The Commissioner may take such action as the Commissioner considers necessary to give effect to a determination under this section.
- (6) The Commissioner must give a copy of a determination under this section to the disadvantaged entity.

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<sup>\*</sup>To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



- (7) A failure to comply with subsection (6) does not affect the validity of the determination.
- (9) An entity may give the Commissioner a written request to make a determination under this section relating to the entity. The Commissioner must decide whether or not to grant the request, and give the entity notice of the Commissioner's decision.
- (10) If the entity is dissatisfied with the Commissioner's decision, the entity may object, in the manner set out in Part IVC of the *Taxation Administration Act 1953*, against that decision.

**815-40 No double taxation**

- (1) The amount of a \*transfer pricing benefit that is negated under this Subdivision for an entity is not to be taken into account again under another provision of this Act to increase the entity's assessable income, reduce the entity's deductions or reduce a \*net capital loss of the entity.
- (2) Subsection (1) has effect despite former section 136AB of the *Income Tax Assessment Act 1936*.
- (3) Nothing in this Subdivision limits Division 820 (about thin capitalisation) in its application to further reduce \*debt deductions of an entity.

**Subdivision 815-B—Arm's length principle for cross-border conditions between entities****Guide to Subdivision 815-B****815-101 What this Subdivision is about**

This Subdivision applies if an entity would otherwise get a tax advantage in Australia from cross-border conditions that are inconsistent with the internationally accepted arm's length principle.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 815-105

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The entity is treated for income tax and withholding tax purposes as if arm's length conditions had operated.

**Table of sections**

**Operative provisions**

815-105	Object
815-110	Operation of Subdivision
815-115	Substitution of arm's length conditions
815-120	When an entity gets a <i>transfer pricing benefit</i>
815-125	Meaning of <i>arm's length conditions</i>
815-130	Relevance of actual commercial or financial relations
815-135	Guidance
815-140	Modification for thin capitalisation
815-145	Consequential adjustments
815-150	Amendment of assessments

**Operative provisions**

**815-105 Object**

- (1) The object of this Subdivision is to ensure that the amount brought to tax in Australia from cross-border conditions between entities is not less than it would be if those conditions reflected:
  - (a) the arm's length contribution made by Australian operations through functions performed, assets used and risks assumed; and
  - (b) the conditions that might be expected to operate between entities dealing at \*arm's length.
- (2) The Subdivision does this by specifying that, where an entity would otherwise get a tax advantage from actual conditions that differ from \*arm's length conditions, the arm's length conditions are taken to operate for income tax and withholding tax purposes.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**815-110 Operation of Subdivision**

- (1) Nothing in the provisions of this Act other than this Subdivision limits the operation of this Subdivision.
- (2) Nothing in this Subdivision limits Division 820 (about thin capitalisation) in its application to reduce, or further reduce, \*debt deductions of an entity.

**815-115 Substitution of arm's length conditions**

- (1) For the purposes covered by subsection (2), if an entity gets a \*transfer pricing benefit from conditions that operate between the entity and another entity in connection with their commercial or financial relations:

- (a) those conditions are taken not to operate; and
- (b) instead, the \*arm's length conditions are taken to operate.

Note 1: The conditions that operate include, but are not limited to, such things as price, gross margin, net profit, and the division of profit between the entities.

Note 2: There are special rules about documentation that affect when an entity has a reasonably arguable position about the application (or non-application) of this Subdivision: see Subdivision 284-E in Schedule 1 to the *Taxation Administration Act 1953*.

- (2) The purposes covered by this subsection are:
  - (a) if the \*transfer pricing benefit arises under subparagraph 815-120(1)(c)(i)—working out the amount (if any) of the entity's taxable income for the income year; and
  - (b) if the transfer pricing benefit arises under subparagraph 815-120(1)(c)(ii)—working out the amount (if any) of the entity's loss of a particular \*sort for the income year; and
  - (c) if the transfer pricing benefit arises under subparagraph 815-120(1)(c)(iii)—working out the amount (if any) of the entity's \*tax offsets for the income year; and
  - (d) if the transfer pricing benefit arises under subparagraph 815-120(1)(c)(iv)—working out the amount (if

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 815-120

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any) of \*withholding tax payable by the entity in respect of interest or royalties.

**815-120 When an entity gets a *transfer pricing benefit***

- (1) An entity gets a *transfer pricing benefit* from conditions that operate between the entity and another entity in connection with their commercial or financial relations if:
  - (a) those conditions (the *actual conditions*) differ from the \*arm's length conditions; and
  - (b) the actual conditions satisfy the cross-border test in subsection (3) for the entity; and
  - (c) had the arm's length conditions operated, instead of the actual conditions, one or more of the following would, apart from this Subdivision, apply:
    - (i) the amount of the entity's taxable income for an income year would be *greater*;
    - (ii) the amount of the entity's loss of a particular \*sort for an income year would be *less*;
    - (iii) the amount of the entity's \*tax offsets for an income year would be *less*;
    - (iv) an amount of \*withholding tax payable in respect of interest or royalties by the entity would be *greater*.

*Absence of condition*

- (2) For the purposes of subsection (1), there is taken to be a difference between the actual conditions and the \*arm's length conditions if:
  - (a) an actual condition exists that is not one of the arm's length conditions; or
  - (b) a condition does not exist in the actual conditions but is one of the arm's length conditions.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Cross-border test*

- (3) Conditions that operate between an entity and another entity in connection with their commercial or financial relations satisfy the cross-border test if:
- (a) the conditions meet the overseas requirement in the following table for either or both of the entities; or
  - (b) the conditions operate in connection with a \*business that the entity carries on in an \*area covered by an international tax sharing treaty.

<b>Overseas requirement</b>		
<b>Item</b>	<b>Column 1 The conditions meet the overseas requirement for this type of entity:</b>	<b>Column 2 if:</b>
1	any of the following: (a) an Australian resident; (b) a resident trust estate for the purposes of Division 6 of Part III of the <i>Income Tax Assessment Act 1936</i> ; (c) a partnership in which all of the partners are, directly or indirectly through one or more interposed partnerships, Australian residents or resident trust estates	the conditions operate at or through an *overseas permanent establishment of the entity.
2	an entity not covered by column 1 of item 1	the conditions do not operate solely at or through an *Australian permanent establishment of the entity.

- (4) For the purposes of the table in subsection (3), treat any entity that is an Australian resident as not being an Australian resident if:
- (a) the entity is also a resident in a country that has entered into an \*international tax agreement with Australia containing a \*residence article; and

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 815-125

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- (b) under that residence article, the entity is taken, for the purposes of the agreement, to be a resident only of that other country.

*Nil amounts*

- (5) For the purposes of this section and section 815-145:
  - (a) treat an entity that has no taxable income for an income year as having a taxable income for the year of a nil amount; and
  - (b) treat an entity that has no loss of a particular \*sort for an income year as having a loss of that sort for the year of a nil amount; and
  - (c) treat an entity that has no \*tax offsets for an income year as having tax offsets for the year of a nil amount.

*Meaning of residence article*

- (6) A **residence article** is:
  - (a) Article 4 of the United Kingdom convention (within the meaning of the *International Tax Agreements Act 1953*); or
  - (b) a corresponding provision of another \*international tax agreement.

**815-125 Meaning of arm's length conditions**

- (1) The **arm's length conditions**, in relation to conditions that operate between an entity and another entity, are the conditions that might be expected to operate between independent entities dealing wholly independently with one another in comparable circumstances.

*Most appropriate and reliable method to be used*

- (2) In identifying the \*arm's length conditions, use the method, or the combination of methods, that is the most appropriate and reliable, having regard to all relevant factors, including the following:
  - (a) the respective strengths and weaknesses of the possible methods in their application to the actual conditions;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the circumstances, including the functions performed, assets used and risks borne by the entities;
- (c) the availability of reliable information required to apply a particular method;
- (d) the degree of comparability between the actual circumstances and the comparable circumstances, including the reliability of any adjustments to eliminate the effect of material differences between those circumstances.

Note: The possible methods include the methods set out in the documents mentioned in section 815-135 (about relevant guidance material).

*Comparability of circumstances*

- (3) In identifying comparable circumstances for the purpose of this section, regard must be had to all relevant factors, including the following:
  - (a) the functions performed, assets used and risks borne by the entities;
  - (b) the characteristics of any property or services transferred;
  - (c) the terms of any relevant contracts between the entities;
  - (d) the economic circumstances;
  - (e) the business strategies of the entities.
- (4) For the purposes of this section, circumstances are comparable to actual circumstances if, to the extent (if any) that the circumstances differ from the actual circumstances:
  - (a) the difference does not materially affect a condition that is relevant to the method; or
  - (b) a reasonably accurate adjustment can be made to eliminate the effect of the difference on a condition that is relevant to the method.

## **815-130 Relevance of actual commercial or financial relations**

*Basic rule*

- (1) The identification of the \*arm's length conditions must:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 815-135**

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- (a) be based on the commercial or financial relations in connection with which the actual conditions operate; and
- (b) have regard to both the form and substance of those relations.

*Exceptions*

- (2) Despite paragraph (1)(b), disregard the form of the actual commercial or financial relations to the extent (if any) that it is inconsistent with the substance of those relations.
- (3) Despite subsection (1), if:
  - (a) independent entities dealing wholly independently with one another in comparable circumstances would not have entered into the actual commercial or financial relations; and
  - (b) independent entities dealing wholly independently with one another in comparable circumstances would have entered into other commercial or financial relations; and
  - (c) those other commercial or financial relations differ in substance from the actual commercial or financial relations; the identification of the \*arm's length conditions must be based on those other commercial or financial relations.
- (4) Despite subsection (1), if independent entities dealing wholly independently with one another in comparable circumstances would not have entered into commercial or financial relations, the identification of the \*arm's length conditions is to be based on that absence of commercial or financial relations.
- (5) Subsections 815-125(3) and (4) (about comparability of circumstances) apply for the purposes of this section.

**815-135 Guidance**

- (1) For the purpose of determining the effect this Subdivision has in relation to an entity, identify \*arm's length conditions so as best to achieve consistency with the documents covered by this section.
- (2) The documents covered by this section are as follows:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) the Transfer Pricing Guidelines for Multinational Enterprises and Tax Administrations, as approved by the Council of the Organisation for Economic Cooperation and Development and last amended on 19 May 2017;
  - (b) a document, or part of a document, prescribed by the regulations for the purposes of this paragraph.
- (3) However, the document mentioned in paragraph (2)(a) is not covered by this section if the regulations so prescribe.
- (4) Regulations made for the purposes of paragraph (2)(b) or subsection (3) may prescribe different documents or parts of documents for different circumstances.

### **815-140 Modification for thin capitalisation**

- (1) This section modifies the way an entity to which section 815-115 applies works out its taxable income, or its loss of a particular \*sort, for an income year, if:
- (a) Division 820 (about thin capitalisation) applies to the entity for the income year; and
  - (b) the \*arm's length conditions affect costs that are \*debt deductions of the entity for the income year.
- (2) If working out what those costs would be if the \*arm's length conditions had operated involves applying a rate to a \*debt interest:
- (a) work out the rate as if the arm's length conditions had operated; but
  - (b) apply the rate to the debt interest the entity actually issued.

Note: Division 820 may apply to reduce or further reduce debt deductions.

### **815-145 Consequential adjustments**

- (1) The Commissioner may make a determination under subsection (2) in relation to an entity (the *disadvantaged entity*) if:
- (a) \*arm's length conditions are taken by section 815-115 to operate; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 815-145

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- (b) the Commissioner considers that, if the arm's length conditions, instead of the actual conditions, had operated:
    - (i) the amount of the disadvantaged entity's taxable income for an income year might have been expected to be *less* than its actual amount; or
    - (ii) the amount of the disadvantaged entity's loss of a particular \*sort for an income year might have been expected to be *greater* than its actual amount; or
    - (iii) the amount of the disadvantaged entity's \*tax offsets for an income year might have been expected to be *greater* than their actual amount; or
    - (iv) an amount of \*withholding tax payable in respect of interest or royalties by the disadvantaged entity might have been expected to be *less* than its actual amount; and
  - (c) the Commissioner considers that it is fair and reasonable that the actual amount mentioned in subparagraph (b)(i), (ii), (iii) or (iv) (as the case requires) be adjusted accordingly.
- (2) For the purpose of adjusting an amount as mentioned in paragraph (1)(c), the Commissioner may make a determination stating the amount that is (and has been at all times) the amount of the disadvantaged entity's:
    - (a) taxable income for the income year; or
    - (b) loss of a particular \*sort for the income year; or
    - (c) \*tax offsets, or tax offset of a particular kind, for the income year; or
    - (d) \*withholding tax payable in respect of interest or royalties.
  - (3) The Commissioner may take such action as the Commissioner considers necessary to give effect to a determination under this section.
  - (4) The Commissioner must give a copy of a determination under this section to the disadvantaged entity.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (5) A failure to comply with subsection (4) does not affect the validity of the determination.
- (7) An entity may give the Commissioner a written request to make a determination under this section relating to the entity. The Commissioner must decide whether or not to grant the request, and give the entity notice of the Commissioner's decision.
- (8) If the entity is dissatisfied with the Commissioner's decision, the entity may object, in the manner set out in Part IVC of the *Taxation Administration Act 1953*, against that decision.

### **815-150 Amendment of assessments**

- (1) Section 170 of the *Income Tax Assessment Act 1936* does not prevent the amendment of an assessment of an entity for an income year if:
  - (a) the amendment is made within 7 years after the day on which the Commissioner gives notice of the assessment to the entity; and
  - (b) the amendment is made for the purpose of giving effect to section 815-115.
- (2) Section 170 of the *Income Tax Assessment Act 1936* does not prevent the amendment of an assessment at any time for the purpose of giving effect to section 815-145.

### **Subdivision 815-C—Arm's length principle for permanent establishments**

#### **Guide to Subdivision 815-C**

#### **815-201 What this Subdivision is about**

This Subdivision applies the internationally accepted arm's length principle in the context of permanent establishments (PEs).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Table of sections

### Operative provisions

815-205	Object
815-210	Operation of Subdivision
815-215	Substitution of arm's length profits
815-220	When an entity gets a <i>transfer pricing benefit</i>
815-225	Meaning of <i>arm's length profits</i>
815-230	Source rules for certain arm's length profits
815-235	Guidance
815-240	Amendment of assessments

## Operative provisions

### 815-205 Object

The object of this Subdivision is to ensure that the amount brought to tax in Australia by entities operating \*permanent establishments is not less than it would be if the permanent establishment were a distinct and separate entity engaged in the same or comparable activities under the same or comparable circumstances, but dealing wholly independently with the other part of the entity.

### 815-210 Operation of Subdivision

- (1) Nothing in the provisions of this Act other than this Subdivision limits the operation of this Subdivision.
- (2) Nothing in this Subdivision limits Division 820 (about thin capitalisation) in its application to reduce, or further reduce, \*debt deductions of an entity.
- (3) For the purposes of this Subdivision, a branch to which subsection 160ZZW(2) of the *Income Tax Assessment Act 1936* (about certain Australian branches of foreign banks) applies is taken not to be, and not to have been at any time since its establishment, a \*permanent establishment in Australia of the bank.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**815-215 Substitution of arm's length profits**

- (1) For the purposes covered by subsection (2), if an entity gets a \*transfer pricing benefit from the attribution of profits to a \*PE of the entity:
- (a) the amount of profits actually attributed to the PE is taken not to have been so attributed; and
  - (b) instead, the \*arm's length profits are taken to have been attributed to the PE.

Note: There are special rules about documentation that affect when an entity has a reasonably arguable position about the application (or non-application) of this Subdivision: see Subdivision 284-E in Schedule 1 to the *Taxation Administration Act 1953*.

- (2) The purposes covered by this subsection are:
- (a) if the \*transfer pricing benefit arises under subparagraph 815-220(1)(b)(i)—working out the amount (if any) of the entity's taxable income for the income year; and
  - (b) if the transfer pricing benefit arises under subparagraph 815-220(1)(b)(ii)—working out the amount (if any) of a loss of a particular \*sort for the income year; and
  - (c) if the transfer pricing benefit arises under subparagraph 815-220(1)(b)(iii)—working out the amount (if any) of the entity's \*tax offsets for the income year.

**815-220 When an entity gets a *transfer pricing benefit***

- (1) An entity gets a ***transfer pricing benefit*** from the attribution of profits to a \*PE of the entity if:
- (a) the amount of profits (the ***actual profits***) attributed to the PE differs from the \*arm's length profits for the PE; and
  - (b) had the arm's length profits, instead of the actual profits, been attributed to the PE, one or more of the following would, apart from this Subdivision, apply:
    - (i) the amount of the entity's taxable income for an income year would be *greater*;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 815-225

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- (ii) the amount of the entity's loss of a particular \*sort for an income year would be *less*;
- (iii) the amount of the entity's \*tax offsets for an income year would be *less*.

*Nil amounts*

- (2) For the purposes of this section:
  - (a) treat an entity that has no taxable income for an income year as having a taxable income for the year of a nil amount; and
  - (b) treat an entity that has no loss of a particular \*sort for an income year as having a loss of that sort for the year of a nil amount; and
  - (c) treat an entity that has no \*tax offsets for an income year as having tax offsets for the year of a nil amount.

**815-225 Meaning of *arm's length profits***

- (1) The *arm's length profits* for a \*PE of an entity are worked out by allocating the actual expenditure and income of the entity between the PE and the entity so that the profits attributed to the PE equal the profits the PE might be expected to make if:
  - (a) the PE were a distinct and separate entity; and
  - (b) the activities and circumstances of the PE, including the functions performed, assets used and risks borne by the PE, were those of that separate entity; and
  - (c) the conditions that operated between that separate entity and the entity of which it is a PE were the \*arm's length conditions.
- (2) The conditions to which the \*arm's length conditions mentioned in paragraph (1)(c) relate are the conditions that would operate between the separate entity and the entity of which it is a \*PE if the assumptions in paragraphs (1)(a) and (b) were made.
- (3) For the purposes of subsection (1):

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) the actual expenditure of an entity is taken to include losses and outgoings; and
- (b) the actual income of an entity is taken to include any amount that is, or is to be, included in the entity's assessable income.

**815-230 Source rules for certain arm's length profits**

- (1) The \*arm's length profits for a \*PE in Australia are taken, for the purposes of this Act, to be attributable to sources in Australia.
- (2) The \*arm's length profits for a \*PE in an \*area covered by an international tax sharing treaty are taken, for the purposes of this Act, to be attributable to sources in that area.

**815-235 Guidance**

- (1) For the purpose of determining the effect this Subdivision has in relation to an entity, work out \*arm's length profits, and identify \*arm's length conditions, so as best to achieve consistency with:
  - (a) the documents covered by this section; and
  - (b) subject to paragraph (a), the documents covered by section 815-135.
- (2) The documents covered by this section are as follows:
  - (a) the Model Tax Convention on Income and on Capital, and its Commentaries, as adopted by the Council of the Organisation for Economic Cooperation and Development and last amended on 22 July 2010, to the extent that document extracts the text of Article 7 and its Commentary as they read before 22 July 2010;
  - (b) a document, or part of a document, prescribed by the regulations for the purposes of this paragraph.
- (3) However, the document mentioned in paragraph (2)(a) is not covered by this section if the regulations so prescribe.
- (4) A document covered by section 815-135 is to be disregarded for the purposes of this section if the regulations so prescribe.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 815-240**

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- (5) Regulations made for the purposes of paragraph (2)(b), subsection (3) or subsection (4) may prescribe different documents or parts of documents for different circumstances.

**815-240 Amendment of assessments**

Section 170 of the *Income Tax Assessment Act 1936* does not prevent the amendment of an assessment of an entity for an income year if:

- (a) the amendment is made within 7 years after the day on which the Commissioner gives notice of the assessment to the entity; and
- (b) the amendment is made for the purpose of giving effect to section 815-215.

**Subdivision 815-D—Special rules for trusts and partnerships**

**Guide to Subdivision 815-D**

**815-301 What this Subdivision is about**

This Subdivision provides special rules about the way Subdivisions 815-B and 815-C apply to trusts and partnerships.

**Table of sections**

**Operative provisions**

- 815-305 Special rule for trusts
- 815-310 Special rules for partnerships

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Operative provisions

### 815-305 Special rule for trusts

Subdivisions 815-B and 815-C apply in relation to the \*net income of a trust in the same way those Subdivisions apply in relation to the taxable income of an entity other than a trust.

### 815-310 Special rules for partnerships

- (1) Subdivisions 815-B and 815-C apply in relation to the \*net income of a partnership in the same way those Subdivisions apply in relation to the taxable income of an entity other than a partnership.
- (2) Subdivisions 815-B and 815-C apply in relation to a \*partnership loss of a partnership in the same way those Subdivisions apply in relation to a \*tax loss of an entity other than a partnership.

## Subdivision 815-E—Reporting obligations for country by country reporting entities

### Guide to Subdivision 815-E

#### 815-350 What this Subdivision is about

CBC reporting entities must give the Commissioner statements under this Subdivision.

Note: This Subdivision enables the implementation of measures issued by the Organisation for Economic Cooperation and Development relating to transfer pricing documentation and country-by-country reporting (including Action 13 of the Action Plan on Base Erosion and Profit Shifting of the G20 and the Organisation for Economic Cooperation and Development)

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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815-360	Replacement reporting periods
815-365	Exemptions
815-370	Meaning of <i>country by country reporting entity</i> (or <i>CBC reporting entity</i> )
815-375	Meaning of <i>country by country reporting parent</i> (or <i>CBC reporting parent</i> )
815-380	Meaning of <i>country by country reporting group</i> (or <i>CBC reporting group</i> )

## Operative provisions

### 815-355 Requirement to give statements

- (1) You must give to the Commissioner a statement of each of the kinds referred to in subsection (3), in the \*approved form, in relation to an income year if:
- (a) you were a \*CBC reporting entity for a period that includes the whole or a part of the income year that preceded that income year; and
  - (b) you are, during that income year, any of the following:
    - (i) an Australian resident;
    - (ii) a resident trust estate for the purposes of Division 6 of Part III of the *Income Tax Assessment Act 1936*;
    - (iii) a partnership that has at least one partner who is an Australian resident;
    - (iv) a foreign resident who operates an Australian permanent establishment (within the meaning of Part IVA of the *Income Tax Assessment Act 1936*);
    - (v) a non-resident trust estate (within the meaning of section 102AAB of the *Income Tax Assessment Act 1936*) that operates an Australian permanent establishment (within the meaning of Part IVA of that Act);
    - (vi) a partnership that operates an Australian permanent establishment (within the meaning of that Part); and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

(c) you are not exempted under section 815-365 from giving the statement; and

(d) you are not included in a class of entities prescribed by the regulations.

Note: Under section 815-360, the Commissioner may allow you to give statements in relation to a 12 month period other than an income year.

(2) You must give the statement within 12 months after the end of the period to which it relates.

Note: Section 388-55 in Schedule 1 to the *Taxation Administration Act 1953* allows the Commissioner to defer the time for giving the statement.

(3) The statements are to be of the following kinds:

(a) a statement relating to the global operations and activities, and the pricing policies relevant to transfer pricing, of:

(i) you; and

(ii) if you are a \*member of a \*CBC reporting group during the income year—the other members of that group;

(b) a statement relating to your operations, activities, dealings and transactions;

(c) a statement relating to the allocation between countries of the income and activities of, and taxes paid by:

(i) you; and

(ii) if subparagraph (a)(ii) applies—the other members of that group.

Note: These statements correspond to the following in Annexes I, II and III to Chapter V set out in the Guidance on Transfer Pricing Documentation and Country-by-country Reporting of the Organisation for Economic Cooperation and Development and the G20:

(a) a statement under paragraph (a) corresponds to the master file (see Annexe I);

(b) a statement under paragraph (b) corresponds to the local file (see Annexe II);

(c) a statement under paragraph (c) corresponds to the country-by-country report (see Annexe III).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 815-360

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**815-360 Replacement reporting periods**

- (1) The Commissioner may, by notice in writing, allow you to give all statements, or specified kinds of statements, under section 815-355 in relation to a 12 month period other than an income year.
- (2) A notice under subsection (1) is not a legislative instrument.

**815-365 Exemptions**

*Exemptions for particular entities*

- (1) The Commissioner may, by notice in writing, exempt an entity from:
  - (a) giving statements under section 815-355; or
  - (b) giving statements of a particular kind under that section.
- (2) A notice under subsection (1) is not a legislative instrument.

*General exemptions*

- (3) The Commissioner may, by legislative instrument, determine that section 815-355 does not apply to a specified class of entity.

**815-370 Meaning of *country by country reporting entity* (or *CBC reporting entity*)**

An entity is a ***country by country reporting entity*** (or ***CBC reporting entity***) for a period if:

- (a) the entity is a \*CBC reporting parent for the period; or
- (b) the entity is a \*member of a \*CBC reporting group during the period and another member of that group is a CBC reporting parent for the period.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**815-375 Meaning of *country by country reporting parent* (or *CBC reporting parent*)**

- (1) An entity is a ***country by country reporting parent*** (or ***CBC reporting parent***) for a period if:
  - (a) the entity is *not* an individual; and
  - (b) if the entity is a \*member of a \*CBC reporting group at the end of the period—it is an entity that, according to:
    - (i) \*accounting principles; or
    - (ii) if accounting principles do not apply in relation to the entity—commercially accepted principles related to accounting;is not controlled by any other member of the CBC reporting group at the end of the period; and
  - (c) the entity's \*annual global income for the period is \$1 billion or more.
- (2) For the purposes of paragraph (1)(c), in working out the entity's \*annual global income for the period, treat the reference in paragraph 960-565(1)(aa) to \*notional listed company group as instead being a reference to \*CBC reporting group.

**815-380 Meaning of *country by country reporting group* (or *CBC reporting group*)**

- (1) A group of entities is a ***country by country reporting group*** (or ***CBC reporting group***) if:
  - (a) none of the entities is an individual; and
  - (b) any of the following requirements are satisfied:
    - (i) the group is consolidated for accounting purposes as a single group;
    - (ii) the group is a \*notional listed company group.
- (2) Each entity in the group is a ***member*** of the \*CBC reporting group.
- (3) Subsection (5) applies if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 815-380

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- (a) all the members of a group that is consolidated for accounting purposes as a single group (the ***smaller group***) are members of:
    - (i) another such group; or
    - (ii) a \*notional listed company group; and
  - (b) at least one entity is a member of the group mentioned in subparagraph (a)(i) or (ii) but is not a member of the smaller group.
- (4) Subsection (5) also applies if:
- (a) all the \*members of a notional listed company group (the ***smaller group***) are members of:
    - (i) another such group; or
    - (ii) a group that is consolidated for accounting purposes as a single group; and
  - (b) at least one entity is a member of the group mentioned in subparagraph (a)(i) or (ii) but is not a member of the smaller group.
- (5) For the purposes of subsection (1), treat the smaller group as not being any of the following:
- (a) a group that is consolidated for accounting purposes as a single group;
  - (b) a \*notional listed company group.
- (6) For the purposes of this section, assume that paragraph 960-575(4)(a) were disregarded:
- (a) in determining whether a \*notional listed company group exists; and
  - (b) in identifying the \*members of a notional listed company group.

Note: The effect of that assumption is that certain exceptions in accounting or other principles to requirements to consolidate for accounting purposes are taken into account in working out the membership of the country by country reporting group. Where such exceptions apply, a country by country reporting group may have fewer members than the equivalent notional listed company group.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Division 820—Thin capitalisation rules**

### **Table of Subdivisions**

	Guide to Division 820
820-A	Preliminary
820-B	Thin capitalisation rules for outward investing entities (non-ADI)
820-C	Thin capitalisation rules for inward investing entities (non-ADI)
820-D	Thin capitalisation rules for outward investing entities (ADI)
820-E	Thin capitalisation rules for inward investing entities (ADI)
820-EA	Some financial entities may choose to be treated as ADIs
820-FA	How the thin capitalisation rules apply to consolidated groups and MEC groups
820-FB	Grouping branches of foreign banks and foreign financial entities with a consolidated group, MEC group or single Australian resident company
820-G	Calculating the average values
820-H	Control of entities
820-HA	Controlled foreign entity debt and controlled foreign entity equity
820-I	Associate entities
820-J	Equity interests in trusts and partnerships
820-JA	Worldwide debt and equity concepts
820-K	Zero-capital amounts
820-KA	Cost-free debt capital and excluded equity interests
820-L	Record keeping requirements

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Guide to Division 820

### 820-1 What this Division is about

This Division applies to foreign controlled Australian entities, Australian entities that operate internationally and foreign entities that operate in Australia.

Financing expenses that an entity can otherwise deduct from its assessable income may be disallowed under this Division in the following circumstances:

- for an entity that is not an authorised deposit-taking institution for the purposes of the *Banking Act 1959* (an **ADI**)—the entity's debt exceeds the prescribed level (and the entity is therefore “thinly capitalised”);
- for an entity that is an ADI—the entity's capital is less than the prescribed level (and the entity is therefore “thinly capitalised”).

### Table of sections

820-5	Does this Division apply to an entity?
820-10	Map of Division

### 820-5 Does this Division apply to an entity?

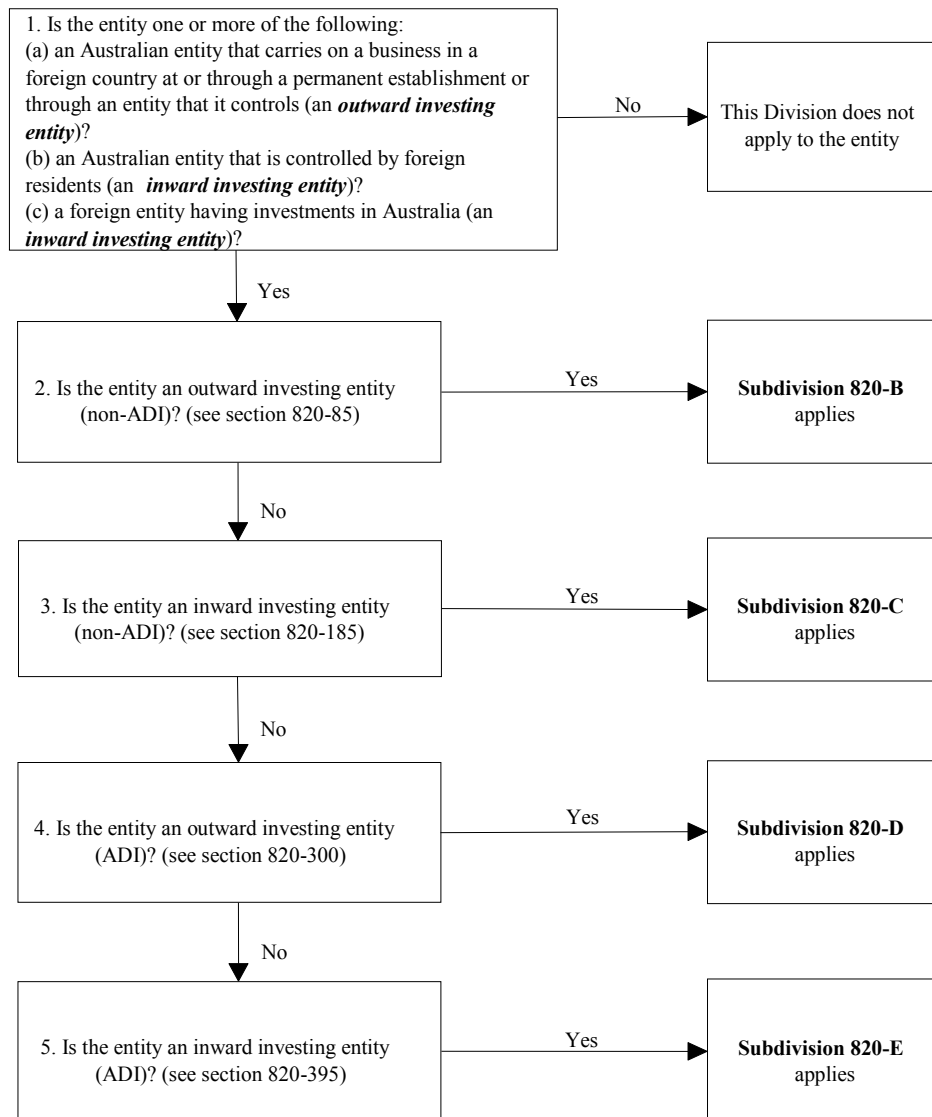
The following diagram shows you how to work out whether this Division applies to an entity.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 820-5**

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-10

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**820-10 Map of Division**

The following table sets out a map of this Division.

<b>Map of Division</b>		
<b>Item</b>	<b>This Subdivision:</b>	<b>sets out:</b>
1	Subdivision 820-B or 820-C	(a) the meaning of maximum allowable debt for the Subdivision; and (b) how an entity covered by the Subdivision would have all or a part of its debt deductions disallowed if the maximum allowable debt is exceeded; and (c) the application of these rules in relation to a part of an income year.
2	Subdivision 820-D or 820-E	(a) the meaning of minimum capital amount for the Subdivision; and (b) how an entity covered by the Subdivision would have all or a part of its debt deductions disallowed if the minimum capital amount is not reached; and (c) the application of these rules in relation to a part of an income year.
3A	Subdivision 820-FA	how this Division applies to a consolidated group or MEC group.
3B	Subdivision 820-FB	special rules for grouping foreign bank branches with a consolidated group, MEC group or single Australian resident company.
4	Subdivision 820-G	the methods of calculating the average value of a matter for the purposes of this Division.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 820-10****Map of Division**

<b>Item</b>	<b>This Subdivision:</b>	<b>sets out:</b>
5	Subdivision 820-H	the rules for determining: (a) whether or not an Australian entity controls a foreign entity (for the purposes of determining whether or not Subdivision 820-B or 820-D applies to that Australian entity); and (b) whether or not an Australian entity is controlled by a foreign entity (for the purposes of determining whether or not Subdivision 820-C applies to that Australian entity).
5A	Subdivision 820-HA	the meaning of controlled foreign entity debt and controlled foreign entity equity for the purposes of this Division.
6	Subdivision 820-I	the meaning of various concepts about associate entity for the purposes of this Division.
7	Subdivision 820-J	the meaning of equity interests in trusts and partnerships for the purposes of this Division.
7A	Subdivision 820-JA	worldwide debt and equity concepts.
8	Subdivision 820-K	the meaning of zero-capital amount for the purposes of this Division.
8A	Subdivision 820-KA	the meaning of cost-free debt capital, and excluded equity interest, for the purposes of this Division.
9	Subdivision 820-L	special record keeping requirements for the purposes of this Division.

**Subdivision 820-A—Preliminary****Table of sections**

820-30	Object of Division
820-32	Exemption for private or domestic assets and non-debt liabilities

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 820-30**

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- 820-35 Application—\$2 million threshold
- 820-37 Application—assets threshold
- 820-39 Exemption of certain special purpose entities
- 820-40 Meaning of debt deduction

**820-30 Object of Division**

The Object of this Division is to ensure that the following entities do not reduce their tax liabilities by using an excessive amount of \*debt capital to finance their Australian operations:

- (a) \*Australian entities that operate internationally;
- (b) Australian entities that are foreign controlled;
- (c) \*foreign entities that operate in Australia.

Note: This Division applies in relation to debt deductions of an entity as reduced, if required, in accordance with Division 815 (about cross-border transfer pricing).

**820-32 Exemption for private or domestic assets and non-debt liabilities**

This Division does not apply to:

- (a) an asset that is used (or held for use) wholly or principally for private or domestic purposes; or
- (b) a \*non-debt liability that is wholly or principally of a private or domestic nature.

**820-35 Application—\$2 million threshold**

Subdivision 820-B, 820-C, 820-D or 820-E does not apply to disallow any \*debt deduction of an entity for an income year if the total debt deductions of that entity and all its \*associate entities for that year are \$2 million or less.

**820-37 Application—assets threshold**

- (1) Subdivision 820-B, 820-C, 820-D or 820-E does not apply to disallow any \*debt deduction of an entity for an income year if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) the entity is an \*outward investing entity (non-ADI) or an \*outward investing entity (ADI) for a period that is all or any part of that year; and
- (b) the entity is not also an \*inward investing entity (non-ADI) or an \*inward investing entity (ADI) for all or any part of that period; and
- (c) the result of applying the following formula is equal to or greater than 0.9:

$$\frac{\text{Sum of the average Australian assets of the entity and the average Australian assets of each of the entity's *associates}}{\text{Sum of the average total assets of the entity and the average total assets of each of the entity's associates}}$$

where:

***average Australian assets:***

- (a) of an \*Australian entity—is the average value, for that year, of all the assets of the entity, other than:
  - (i) any assets attributable to the entity's \*overseas permanent establishments; or
  - (ii) any \*debt interests held by the entity, to the extent to which any value of the interests is all or a part of the \*controlled foreign entity debt of the entity; or
  - (iii) any \*equity interests or debt interests held by the entity, to the extent to which any value of the interests is all or a part of the \*controlled foreign entity equity of the entity; or
  - (iv) any debt interests that are \*issued by \*associates of the entity, that are \*on issue, and that are held by the entity; or
  - (v) any equity interests that the entity holds in associates of the entity; and
- (b) of a \*foreign entity—is the average value, for that year, of all the assets of the entity that are:
  - (i) located in Australia; or
  - (ii) attributable to the entity's \*Australian permanent establishments; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-37

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- (iii) debt interests held by the entity, to the extent to which the interests are covered by subsection (2); or
  - (iv) equity interests held by the entity, to the extent to which the interests are covered by subsection (3);
- other than:
- (v) any debt interests that are issued by associates of the entity, that are on issue, and that are held by the entity; or
  - (vi) any equity interests that the entity holds in associates of the entity.

**average total assets** of an entity is the average value, for that year, of all the assets of the entity, other than:

- (a) any \*debt interests that are \*issued by \*associates of the entity, that are \*on issue, and that are held by the entity; or
- (b) any \*equity interests that the entity holds in associates of the entity.

*Foreign entity—debt interest issued by an Australian entity*

- (2) If a \*foreign entity holds a \*debt interest that:

- (a) was \*issued by an \*Australian entity; and
- (b) is \*on issue;

this subsection covers the interest to the extent to which the interest is not attributable to any \*overseas permanent establishments of the Australian entity.

*Foreign entity—equity interest in an Australian entity*

- (3) If a \*foreign entity holds an \*equity interest in an \*Australian entity, this subsection covers the interest to the extent to which the interest is not attributable to any \*overseas permanent establishments of the Australian entity.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**820-39 Exemption of certain special purpose entities**

- (1) Subdivision 820-B, 820-C, 820-D or 820-E does not apply to disallow any \*debt deduction of an entity for an income year if the entity meets the conditions in subsection (3) throughout the income year.
- (2) Subdivision 820-B, 820-C, 820-D or 820-E does not apply to disallow any \*debt deduction of an entity for an income year that is an amount incurred by the entity during a part of that year, if the entity meets the conditions in subsection (3) throughout that part.
- (3) The conditions are:
  - (a) the entity is one established for the purposes of managing some or all of the economic risk associated with assets, liabilities or investments (whether the entity assumes the risk from another entity or creates the risk itself); and
  - (b) the total value of \*debt interests in the entity is at least 50% of the total value of the entity's assets; and
  - (c) the entity is an insolvency-remote special purpose entity according to criteria of an internationally recognised rating agency that are applicable to the entity's circumstances.
- (4) The condition in paragraph (3)(c) can be met without the rating agency determining that the entity meets those criteria.

Note 1: While an entity meets the conditions in subsection (3), it is treated for the purposes of this Division as *not* being a member of a consolidated group or MEC group (see section 820-584).

Note 2: An entity that does not qualify for the exemption in this section may still be a securitisation vehicle under subsection 820-942(2), in which case the value of its securitised assets will count towards its zero-capital amount under Subdivision 820-K.

*Multi-tier special purpose entities*

- (5) An entity is taken to meet the conditions in subsection (3) throughout a period that is all or part of an income year, if the entity is one of 2 or more entities that together satisfy the condition that, assuming:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-40

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- (a) each of the entities had been a division or part of the same entity (the **notional entity**), rather than a separate entity, throughout that period; and
  - (b) the notional entity had consisted only of those divisions and parts throughout that period;
- the notional entity would meet the conditions in subsection (3) throughout that period.

**820-40 Meaning of debt deduction**

- (1) **Debt deduction**, of an entity and for an income year, is a cost incurred by the entity in relation to a \*debt interest issued by the entity, to the extent to which:
  - (a) the cost is:
    - (i) interest, an amount in the nature of interest, or any other amount that is calculated by reference to the time value of money; or
    - (ii) the difference between the \*financial benefits received, or to be received, by the entity under the \*scheme giving rise to the debt interest and the financial benefits provided, or to be provided, under that scheme; or
    - (iii) any amount directly incurred in obtaining or maintaining the financial benefits received, or to be received, by the entity under the scheme giving rise to the debt interest; or
    - (iv) any other expense incurred by the entity that is specified in the regulations made for the purposes of this subparagraph; and
  - (b) the entity can, apart from this Division, deduct the cost from its assessable income for that year;
- (2) A cost covered by paragraph (1)(a) includes, but is not limited to, any of the following:
  - (a) an amount in substitution for interest;
  - (b) a discount in respect of a security;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (c) a fee or charge in respect of a debt, including application fees, line fees, service fees, brokerage and stamp duty in respect of document registration or security for the debt interest;
  - (d) an amount that is taken under an <sup>\*</sup>income tax law to be an amount of interest in respect of a lease, a hire purchase arrangement or any other <sup>\*</sup>arrangement specified in that law;
  - (e) any loss in respect of:
    - (i) a reciprocal purchase agreement (otherwise known as a repurchase agreement);
    - (ii) a sell-buyback arrangement;
    - (iii) a securities loan arrangement;
  - (f) any amount covered by paragraph (1)(a) that has been assigned or is dealt with in any way on behalf of the party who would otherwise be entitled to that amount.
- (3) To avoid doubt, the following amounts that are incurred by an entity in relation to a <sup>\*</sup>debt interest issued by the entity are not covered by paragraph (1)(a):
- (a) losses and outgoings directly associated with hedging or managing the financial risk in respect of the debt interest;
  - (b) losses incurred by the entity in relation to which the following apply:
    - (i) the losses would otherwise be a cost covered by subparagraph (1)(a)(ii); but
    - (ii) the benefits mentioned in that subparagraph are measured in a foreign currency or a unit of account other than Australian currency (for example, ounces of gold) and the losses have arisen only because of changes in the rate of converting that foreign currency or that unit of account into Australian currency;
  - (c) salary or wages;
  - (d) rental expenses for a lease if the lease is not a debt interest;
  - (e) an expense specified in the regulations made for the purposes of this paragraph.

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<sup>\*</sup>To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Subdivision 820-B—Thin capitalisation rules for outward investing entities (non-ADI)

### Guide to Subdivision 820-B

#### 820-65 What this Subdivision is about

This Subdivision sets out the thin capitalisation rules that apply to an Australian entity that has certain types of overseas investments and is not an authorised deposit-taking institution (an *ADI*). These rules deal with the following matters:

- how to work out the entity's maximum allowable debt for an income year;
- how all or a part of the debt deductions claimed by the entity may be disallowed if the maximum allowable debt is exceeded;
- how to apply these rules to a period that is less than an income year.

#### Table of sections

##### Operative provisions

820-85	Thin capitalisation rule for outward investing entities (non-ADI)
820-90	Maximum allowable debt
820-95	Safe harbour debt amount—outward investor (general)
820-100	Safe harbour debt amount—outward investor (financial)
820-105	Arm's length debt amount
820-110	Worldwide gearing debt amount—outward investor that is not also an inward investment vehicle
820-111	Worldwide gearing debt amount—outward investor that is also an inward investment vehicle
820-115	Amount of debt deduction disallowed
820-120	Application to part year periods

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Operative provisions

### 820-85 Thin capitalisation rule for outward investing entities (non-ADI)

#### *Thin capitalisation rule*

- (1) This subsection disallows all or a part of each \*debt deduction of an entity for an income year (to the extent that it is not attributable to an \*overseas permanent establishment of the entity) if, for that year:
- (a) the entity is an \*outward investing entity (non-ADI) (see subsection (2)); and
  - (b) the entity's \*adjusted average debt (see subsection (3)) exceeds its \*maximum allowable debt (see section 820-90).

Note 1: This Subdivision does not apply if the total debt deductions of that entity and all its associate entities for that year are \$2 million or less, see section 820-35.

Note 2: To work out the amount to be disallowed, see section 820-115.

Note 3: For the rules that apply to an entity that is an outward investing entity (non-ADI) for only a part of an income year, see section 820-120 in conjunction with subsection (2) of this section.

Note 4: A consolidated group or MEC group may be an outward investing entity (non-ADI) to which this Subdivision applies: see Subdivisions 820-FA and 820-FB.

#### *Outward investing entity (non-ADI)*

- (2) The entity is an **outward investing entity (non-ADI)** for a period that is all or a part of an income year if, and only if, it is:
- (a) an \*outward investor (general) for that period (as set out in items 1 and 3 of the following table); or
  - (b) an \*outward investor (financial) for that period (as set out in items 2 and 4 of that table).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 820-85

<b>Outward investing entity (non-ADI)</b>			
<b>Item</b>	<b>If:</b>	<b>and:</b>	<b>then:</b>
1	the entity (the <b><i>relevant entity</i></b> ) is one or both of the following throughout a period that is all or a part of an income year: (a) an *Australian controller of at least one *Australian controlled foreign entity (not necessarily the same Australian controlled foreign entity throughout that period); (b) an Australian entity that carries on a *business at or through at least one *overseas permanent establishment (not necessarily the same permanent establishment throughout that period)	the relevant entity is not a *financial entity, nor an *ADI, at any time during that period	the relevant entity is an <b><i>outward investor (general)</i></b> for that period
2	the entity (the <b><i>relevant entity</i></b> ) satisfies this column in item 1	the relevant entity is a *financial entity throughout that period	the relevant entity is an <b><i>outward investor (financial)</i></b> for that period
3	(a) the entity (the <b><i>relevant entity</i></b> ) is an *Australian entity throughout a period that is all or a part of an income year; and (b) throughout that period, the relevant entity is an *associate entity of another Australian entity; and (c) that other Australian entity is an *outward investing entity (non-ADI) or an *outward investing entity (ADI) for that period	the relevant entity is not a *financial entity, nor an *ADI, at any time during that period	the relevant entity is an <b><i>outward investor (general)</i></b> for that period

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Outward investing entity (non-ADI)**

<b>Item</b>	<b>If:</b>	<b>and:</b>	<b>then:</b>
4	the entity (the <i>relevant entity</i> ) and another Australian entity satisfy this column in item 3	the relevant entity is a <i>*financial</i> entity throughout that period	the relevant entity is an <i>outward investor (financial)</i> for that period

Note 1: To determine whether an entity is an Australian controller of an Australian controlled foreign entity, see Subdivision 820-H.

Note 2: The rules that apply to an outward investor (general) are different from those that apply to an outward investor (financial) in some instances. For example, see sections 820-95 and 820-100.

*Adjusted average debt*

- (3) The entity's *adjusted average debt* for an income year is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to the entity's *\*overseas permanent establishments*.

*Method statement*

- Step 1. Work out the average value, for that year (the *relevant year*), of all the *\*debt* capital of the entity that gives rise to *\*debt* deductions of the entity for that or any other income year.
- Step 2. Reduce the result of step 1 by the average value, for the relevant year, of all the *\*associate entity debt* of the entity.
- Step 3. Reduce the result of step 2 by the average value, for the relevant year, of all the *\*controlled foreign entity debt* of the entity.

*\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.*

Section 820-90

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Step 4. If the entity is a \*financial entity throughout the relevant year, add to the result of step 3 the average value, for the relevant year, of the entity's \*borrowed securities amount.

Step 5. Add to the result of step 4 the average value, for the relevant year, of the \*cost-free debt capital of the entity. The result of this step is the **adjusted average debt**.

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

- (4) The entity's \*adjusted average debt does not exceed its \*maximum allowable debt if the adjusted average debt is nil or a negative amount.

**820-90 Maximum allowable debt**

*Entity is not also an inward investment vehicle (general) or inward investment vehicle (financial)*

- (1) The entity's **maximum allowable debt** for an income year is the greatest of the following amounts if the entity is not also an \*inward investment vehicle (general) or an \*inward investment vehicle (financial) for all or any part of that year:
- (a) the \*safe harbour debt amount;
  - (b) the \*arm's length debt amount;
  - (c) unless the entity has \*worldwide equity of nil or a negative amount—the \*worldwide gearing debt amount.

Note 1: The safe harbour debt amount differs depending on whether the entity is an outward investor (general) or an outward investor (financial), see sections 820-95 and 820-100.

Note 2: The worldwide gearing debt amount for an entity that is not also an inward investment vehicle (general) or an inward investment vehicle (financial) differs depending on whether the entity is an outward investor (general) or an outward investor (financial), see section 820-110.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Entity is also an inward investment vehicle (general) or inward investment vehicle (financial)*

- (2) The entity's **maximum allowable debt** for an income year is the greatest of the following amounts if the entity is also an \*inward investment vehicle (general) or an \*inward investment vehicle (financial) for all or any part of that year:
- (a) the \*safe harbour debt amount;
  - (b) the \*arm's length debt amount;
  - (c) unless subsection (3) applies to the entity—the \*worldwide gearing debt amount.

Note 1: The safe harbour debt amount differs depending on whether the entity is an outward investor (general) or an outward investor (financial), see sections 820-95 and 820-100.

Note 2: The worldwide gearing debt amount for an entity that is also an inward investment vehicle (general) or an inward investment vehicle (financial) differs depending on whether the entity is an outward investor (general) or an outward investor (financial), see section 820-111.

*Inward investment vehicles that are not eligible for the worldwide gearing debt amount*

- (3) This subsection applies to an entity, if:
- (a) the entity has \*statement worldwide equity, or \*statement worldwide assets, of nil or a negative amount; or
  - (b) \*audited consolidated financial statements for the entity for the income year do not exist; or
  - (c) the result of applying the following formula is greater than 0.5:

$$\frac{\text{Average Australian assets of the entity}}{\text{*Statement worldwide assets of the entity for the income year}}$$

where:

**average Australian assets** of an entity is the average value, for the statement period mentioned in subsection (4), of all the assets of the entity, other than:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-95

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- (a) any assets attributable to the entity's \*overseas permanent establishments; or
  - (b) any \*debt interests held by the entity, to the extent to which any value of the interests is all or a part of the \*controlled foreign entity debt of the entity; or
  - (c) any \*equity interests or debt interests held by the entity, to the extent to which any value of the interests is all or a part of the \*controlled foreign entity equity of the entity.
- (4) For the purposes of the definition of **average Australian assets** in subsection (3) the statement period is the period for which the \*audited consolidated financial statements for the entity for the income year have been prepared.
- (5) For the purposes of the formula in paragraph (3)(c), if:
  - (a) an amount is included in \*statement worldwide assets in respect of an asset; and
  - (b) the asset was acquired, held or otherwise dealt with by an entity for a purpose (other than an incidental purpose) that included ensuring that subsection (3) does not apply to an entity; and
  - (c) as a result of the acquisition, holding or dealing with of the asset, the amount included in statement worldwide assets exceeds the amount (including nil) that would otherwise be so included;apply the amount of the excess to reduce statement worldwide assets (or statement worldwide assets as reduced by a previous application of this subsection).

**820-95 Safe harbour debt amount—outward investor (general)**

If the entity is an \*outward investor (general) for the income year, the **safe harbour debt amount** is the result of applying the method statement in this section. In applying the method statement, disregard any amount that is attributable to the entity's \*overseas permanent establishments.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Method statement*

- Step 1. Work out the average value, for the income year, of all the assets of the entity.
- Step 1A. Reduce the result of step 1 by the average value, for that year, of all the \*excluded equity interests in the entity.
- Step 2. Reduce the result of step 1A by the average value, for that year, of all the \*associate entity debt of the entity.
- Step 3. Reduce the result of step 2 by the average value, for that year, of all the \*associate entity equity of the entity.
- Step 4. Reduce the result of step 3 by the average value, for that year, of all the \*controlled foreign entity debt of the entity.
- Step 5. Reduce the result of step 4 by the average value, for that year, of all the \*controlled foreign entity equity of the entity.
- Step 6. Reduce the result of step 5 by the average value, for that year, of all the \*non-debt liabilities of the entity. If the result of this step is a negative amount, it is taken to be nil.
- Step 7. Multiply the result of step 6 by  $\frac{3}{5}$ .
- Step 8. Add to the result of step 7 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **safe harbour debt amount**.

Example: AK Pty Ltd, a company that is an Australian entity, has an average value of assets (other than assets attributable to its overseas permanent establishments) of \$100 million.

The average values of its excluded equity interests, associate entity debt, associate entity equity, controlled foreign entity debt, controlled

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-100

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foreign entity equity and non-debt liabilities are \$5 million, \$10 million, \$8 million, \$5 million, \$2 million and \$5 million respectively. Deducting these amounts from the result of step 1 (through applying steps 1A to 6) leaves \$65 million. Multiplying \$65 million by  $\frac{3}{5}$  results in \$39 million. As the average value of the company's associate entity excess amount is \$4.5 million, the safe harbour debt amount is therefore \$43.5 million.

**820-100 Safe harbour debt amount—outward investor (financial)**

- (1) If the entity is an \*outward investor (financial) for the income year, the **safe harbour debt amount** is the lesser of the following amounts:

- (a) the \*total debt amount (worked out under subsection (2));
- (b) the \*adjusted on-lent amount (worked out under subsection (3)).

However, if the 2 amounts are equal, it is the total debt amount.

*Total debt amount*

- (2) The **total debt amount** is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to the entity's \*overseas permanent establishments.

*Method statement*

- Step 1. Work out the average value, for the income year, of all the assets of the entity.
- Step 1A. Reduce the result of step 1 by the average value, for that year, of all the \*excluded equity interests in the entity.
- Step 2. Reduce the result of step 1A by the average value, for that year, of all the \*associate entity debt of the entity.
- Step 3. Reduce the result of step 2 by the average value, for that year, of all the \*associate entity equity of the entity.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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|----------|--|
| Step 4.  | Reduce the result of step 3 by the average value, for that year, of all the *controlled foreign entity debt of the entity.   |
| Step 5.  | Reduce the result of step 4 by the average value, for that year, of all the *controlled foreign entity equity of the entity.   |
| Step 6.  | Reduce the result of step 5 by the average value, for that year, of all the *non-debt liabilities of the entity.   |
| Step 7.  | Reduce the result of step 6 by the average value, for that year, of the entity's *zero-capital amount. If the result of this step is a negative amount, it is taken to be nil. |
| Step 8.  | Multiply the result of step 7 by $^{15}/_{16}$ .   |
| Step 9.  | Add to the result of step 8 the average value, for that year, of the entity's *zero-capital amount.  |
| Step 10. | Add to the result of step 9 the average value, for that year, of the entity's *associate entity excess amount. The result of this step is the <b>total debt amount</b> .       |

Example: GLM Limited, a company that is an Australian entity, has an average value of assets (other than assets attributable to its overseas permanent establishments) of \$160 million.

The average values of its relevant excluded equity interests, associate entity debt, associate entity equity, controlled foreign entity debt, controlled foreign entity equity, non-debt liabilities and zero-capital amount are \$5 million, \$5 million, \$5 million, \$9 million, \$6 million, \$5 million and \$4 million respectively. Deducting these amounts from the result of step 1 (through applying steps 1A to 7) leaves \$121 million. Multiplying \$121 million by  $^{15}/_{16}$  results in \$113.4375 million. Adding the average zero-capital amount of \$4 million results in \$117.4375 million. As the company does not have any associate entity excess amount, the total debt amount is therefore \$117.4375 million.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Adjusted on-lent amount*

- (3) The **adjusted on-lent amount** is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to the entity's \*overseas permanent establishments.

*Method statement*

- Step 1. Work out the average value, for the income year, of all the assets of the entity.
- Step 1A. Reduce the result of step 1 by the average value, for that year, of all the \*excluded equity interests in the entity.
- Step 2. Reduce the result of step 1A by the average value, for that year, of all the \*associate entity equity of the entity.
- Step 3. Reduce the result of step 2 by the average value, for that year, of all the \*controlled foreign entity debt of the entity.
- Step 4. Reduce the result of step 3 by the average value, for that year, of all the \*controlled foreign entity equity of the entity.
- Step 5. Reduce the result of step 4 by the average value, for that year, of all the \*non-debt liabilities of the entity.
- Step 6. Reduce the result of step 5 by the amount (the **average on-lent amount**) which is the average value, for that year, of the entity's \*on-lent amount (other than \*controlled foreign entity debt of the entity). If the result of this step is a negative amount, it is taken to be nil.
- Step 7. Multiply the result of step 6 by  $\frac{3}{5}$ .
- Step 8. Add to the result of step 7 the average on-lent amount.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- Step 9. Reduce the result of step 8 by the average value, for that year, of all the \*associate entity debt of the entity.
- Step 10. Add to the result of step 9 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **adjusted on-lent amount**.

**Example:** GLM Limited, a company that is an Australian entity, has an average value of assets (other than assets attributable to its overseas permanent establishments) of \$160 million.

The average values of its relevant excluded equity interests, associate entity equity, controlled foreign entity debt, controlled foreign entity equity, non-debt liabilities and on-lent amount are \$5 million, \$5 million, \$9 million, \$6 million, \$5 million and \$35 million respectively. Deducting these amounts from the result of step 1 (through applying steps 1A to 6) leaves \$95 million. Multiplying \$95 million by  $\frac{3}{5}$  results in \$57 million. Adding the average on-lent amount of \$35 million results in \$92 million. Reducing the result of step 8 by the associate entity debt amount of \$5 million equals \$87 million. As the company does not have any associate entity excess amount, the adjusted on-lent amount is therefore \$87 million.

### 820-105 Arm's length debt amount

- (1) The **arm's length debt amount** is a notional amount that, having regard to the factual assumptions set out in subsection (2) and the relevant factors mentioned in subsection (3), would satisfy both paragraphs (a) and (b):
- (a) the amount represents a notional amount of \*debt capital that:
    - (i) the entity would reasonably be expected to have throughout the income year; and
    - (ii) would give rise to an amount of \*debt deductions of the entity for that or any other income year; and
    - (iii) would be attributable to the entity's Australian business as mentioned in subsection (2);
  - (b) commercial lending institutions that were not \*associates of the entity (the **notional lenders**) would reasonably be expected to have entered into \*schemes that would:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-105

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- (i) give rise to \*debt interests that constituted that notional amount of debt capital of the entity; and
- (ii) provide for terms and conditions for the debt interests that would reasonably be expected to have applied if the entity and the notional lenders had been dealing at \*arm's length with each other throughout the income year mentioned in subparagraph (1)(a)(i).

Note: The entity must keep records in accordance with section 820-980 if the entity works out an amount under this section.

*Factual assumptions*

- (2) Irrespective of what actually happened during that year, the following assumptions must be made in working out that amount:
  - (a) the entity's commercial activities in connection with Australia (the **Australian business**) during that year do not include:
    - (i) any \*business carried on by the entity at or through its \*overseas permanent establishments; and
    - (ii) the holding of any \*associate entity debt, \*controlled foreign entity debt or \*controlled foreign entity equity; and
  - (b) the entity had carried on the Australian business that it actually carried on during that year;
  - (c) the nature of the entity's assets and liabilities (to the extent that they are attributable to the Australian business) had been as they were during that year;
  - (d) except as stated in paragraph (1)(b) and paragraphs (e), (f) and (g) of this subsection, the entity had carried on the Australian business in the same circumstances as what actually existed during that year;
  - (e) any guarantee, security or other form of credit support provided to the entity in relation to the Australian business during that year:
    - (i) by its \*associates; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) by the use of assets of the entity that are attributable to the entity's overseas permanent establishments;  
is taken not to have been received by the entity;
- (f) the entity's only activities during that year were the Australian business;
- (g) the entity's only assets and liabilities during that year were those referred to in paragraph (c) of this subsection.

However, the assumptions set out in paragraphs (f) and (g) of this subsection are not to be made in taking into account the relevant factors mentioned in subsection (3).

*Relevant factors*

- (3) On the basis of the factual assumptions set out in subsection (2), the following factors must be taken into account in determining whether or not an amount satisfies paragraphs (1)(a) and (b):
  - (a) the functions performed, the assets used, and the risks assumed, by the entity in relation to the Australian business throughout that year;
  - (b) the terms and conditions of the \*debt capital that the entity actually had in relation to the Australian business throughout that year;
  - (c) the nature of, and title to, any assets of the entity attributable to the Australian business that were available to the entity throughout that year as security for its debt capital for that business;
  - (d) the purposes for which \*schemes for debt capital had been actually entered into by the entity in relation to the Australian business throughout that year;
  - (e) the entity's capacity to meet all its liabilities in relation to the Australian business (whether during that year or at any other time);
  - (f) the profit of the entity (within the meaning of the \*accounting standards), and the return on its capital, in relation to the Australian business (whether during that year or at any other time);

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (g) the debt to equity ratios of the following throughout that year:
  - (i) the entity;
  - (ii) the entity in relation to the Australian business;
  - (iii) each of the entity's \*associate entities that engage in commercial activities similar to the Australian business;
  - (iv) each other entity in which the entity has a direct or indirect interest;
- (h) the commercial practices adopted by independent parties dealing with each other at \*arm's length in the industry in which the entity carries on the Australian business throughout that year (whether in Australia or in comparable markets elsewhere);
- (i) the way in which the entity financed its commercial activities (other than the Australian business) throughout that year;
- (j) the general state of the Australian economy throughout that year;
- (k) all of the above factors existing at the time when the entity last entered into a scheme that gave rise to an actual \*debt interest attributable to the Australian business that remains \*on issue throughout that year;
- (l) any other factors which are specified in the regulations made for the purposes of this section, including factors specific to an \*outward investor (general) or an \*outward investor (financial).

*Commissioner's power*

- (4) If the Commissioner considers an amount worked out by the entity under this section does not appropriately take into account the factual assumptions and the relevant factors, the Commissioner may substitute another amount that the Commissioner considers better reflects those assumptions and factors.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**820-110 Worldwide gearing debt amount—outward investor that is not also an inward investment vehicle**

*Outward investor (general) that is not also an inward investment vehicle (general)*

- (1) If the entity is an \*outward investor (general) for the income year, and not also an \*inward investment vehicle (general) for all or any part of that year, the **worldwide gearing debt amount** is the result of applying the method statement in this subsection.

*Method statement*

- Step 1. Divide the average value of all the entity's \*worldwide debt for the income year by the average value of all the entity's \*worldwide equity for that year.
- Step 3. Add 1 to the result of step 1.
- Step 4. Divide the result of step 1 by the result of step 3.
- Step 5. Multiply the result of step 4 in this method statement by the result of step 6 in the method statement in section 820-95.
- Step 6. Add to the result of step 5 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **worldwide gearing debt amount**.

Example: AK Pty Ltd, a company that is an Australian entity, has an average value of worldwide debt of \$90 million and an average value of worldwide equity of \$30 million. The result of applying step 1 is therefore 3. Dividing 3 by 4 (through applying steps 3 and 4) and multiplying the result by \$65 million (which is the result of step 6 in the method statement in section 820-95) equals \$48.75 million. As the average value of the company's associate entity excess amount is \$4.5 million, the worldwide gearing debt amount is therefore \$53.25 million.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Outward investor (financial) that is not also an inward investment vehicle (financial)*

- (2) If the entity is an \*outward investor (financial) for that year, and not also an \*inward investment vehicle (financial) for all or any part of that year, the **worldwide gearing debt amount** is the result of applying the method statement in this subsection.

*Method statement*

- Step 1. Divide the average value of all the entity's \*worldwide debt for the income year by the average value of all the entity's \*worldwide equity for that year.
- Step 3. Add 1 to the result of step 1.
- Step 4. Divide the result of step 1 by the result of step 3.
- Step 5. Multiply the result of step 4 in this method statement by the result of step 7 in the method statement in subsection 820-100(2).
- Step 6. Add to the result of step 5 the average value, for that year, of the entity's \*zero-capital amount (other than any zero-capital amount that is attributable to the entity's \*overseas permanent establishments).
- Step 7. Add to the result of step 6 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **worldwide gearing debt amount**.

Example: GLM Limited, a company that is an Australian entity, has an average value of worldwide debt of \$120 million and an average value of worldwide equity of \$40 million. The result of applying step 1 is therefore 3. Dividing 3 by 4 (through applying steps 3 and 4) and multiplying the result by \$121 million (which is the result of step 7 of the method statement in subsection 820-100(2)) equals \$90.75 million. The average value of zero-capital amount (see step 7 of the method statement in subsection 820-100(2)) is \$4 million. Adding that amount

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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to \$90.75 million results in \$94.75 million. As the company does not have any associate entity excess amount, the worldwide gearing debt amount is therefore \$94.75 million.

### **820-111 Worldwide gearing debt amount—outward investor that is also an inward investment vehicle**

#### *Outward investor (general)*

- (1) If the entity is an \*outward investor (general) for the income year, and is also an \*inward investment vehicle (general) for all or any part of that year, the **worldwide gearing debt amount** is the result of applying the method statement in this subsection.

#### *Method statement*

- Step 1. Divide the entity's \*statement worldwide debt for the income year by the entity's \*statement worldwide equity for that year.
- Step 2. Add 1 to the result of step 1.
- Step 3. Divide the result of step 1 by the result of step 2.
- Step 4. Multiply the result of step 3 in this method statement by the result of step 6 in the method statement in section 820-95.
- Step 5. Add to the result of step 4 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **worldwide gearing debt amount**.

Example: RKR Limited, a company that is an Australian entity, has a worldwide parent entity in Canada. RKR Limited also has permanent establishments in Singapore. RKR Limited has statement worldwide debt of \$120 million and statement worldwide equity of \$40 million. The result of applying step 1 is therefore 3. Dividing 3 by 4 (through applying steps 2 and 3) and multiplying the result by \$75 million (which is the result of step 6 of the method statement in section 820-95) equals \$56.25 million. As the average value of the

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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company's associate entity excess amount is \$4 million, the worldwide gearing debt amount is therefore \$60.25 million.

*Outward investor (financial)*

- (2) If the entity is an \*outward investor (financial) for the income year, and is also an \*inward investment vehicle (financial) for all or any part of that year, the **worldwide gearing debt amount** is the result of applying the method statement in this subsection.

*Method statement*

- Step 1. Divide the entity's \*statement worldwide debt for the income year by the entity's \*statement worldwide equity for that year.
- Step 2. Add 1 to the result of step 1.
- Step 3. Divide the result of step 1 by the result of step 2.
- Step 4. Multiply the result of step 3 in this method statement by the result of step 7 in the method statement in subsection 820-100(2).
- Step 5. Add to the result of step 4 the average value, for that year, of the entity's \*zero-capital amount (other than any zero-capital amount that is attributable to the entity's \*overseas permanent establishments).
- Step 6. Add to the result of step 5 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **worldwide gearing debt amount**.

Example: TRR Limited, a company that is an Australian entity, has a worldwide parent entity in the United States of America. TRR Limited also has permanent establishments in Malaysia. TRR Limited has statement worldwide debt of \$90 million and statement worldwide equity of \$30 million. The result of applying step 1 is therefore 3. Dividing 3 by 4 (through applying steps 2 and 3) and multiplying the result by \$100 million (which is the result of step 7 of the method statement in

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

subsection 820-100(2)) equals \$75 million. The zero capital amount is \$5 million. Adding that amount to \$75 million results in \$80 million. As the company does not have any associate entity excess amount, the worldwide gearing debt amount is therefore \$80 million.

### 820-115 Amount of debt deduction disallowed

The amount of \*debt deduction disallowed under subsection 820-85(1) is worked out using the following formula:

$$\text{Debt deduction} \times \frac{\text{Excess debt}}{\text{Average debt}}$$

where:

**average debt** means the sum of:

- (a) the average value, for the income year, of the entity's \*debt capital that is covered by step 1 of the method statement in subsection 820-85(3); and
- (b) the average value, for that year, of the entity's \*cost-free debt capital that is covered by step 5 of that method statement; (disregarding any amount that is attributable to the entity's \*overseas permanent establishments in working out the average values).

**debt deduction** means each \*debt deduction covered by subsection 820-85(1).

**excess debt** means the amount by which the entity's \*adjusted average debt for that year (see subsection 820-85(3)) exceeds its \*maximum allowable debt for that year.

Note: The disallowed amount also does not form part of the cost base of a CGT asset. See section 110-54.

### 820-120 Application to part year periods

- (1) This subsection disallows all or a part of each \*debt deduction of an entity for an income year that is an amount incurred by the entity during a period that is a part of that year (to the extent that it

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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is not attributable to an \*overseas permanent establishment of the entity), if:

- (a) the entity is an \*outward investing entity (non-ADI) for that period; and
- (b) the entity's \*adjusted average debt for that period exceeds the entity's \*maximum allowable debt for that period.

Note: To determine whether an entity is an outward investing entity (non-ADI) for that period, see subsection 820-85(2).

- (2) The entity's **adjusted average debt** for that period is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to the entity's \*overseas permanent establishments.

*Method statement*

- Step 1. Work out the average value, for that period, of all the \*debt capital of the entity that gives rise to \*debt deductions of the entity for that or any other income year.
- Step 2. Reduce the result of step 1 by the average value, for that period, of all the \*associate entity debt of the entity.
- Step 3. Reduce the result of step 2 by the average value, for that period, of all the \*controlled foreign entity debt of the entity.
- Step 4. If the entity is a \*financial entity throughout that period, add to the result of step 3 the average value, for that period, of the entity's \*borrowed securities amount.
- Step 5. Add to the result of step 4 the average value, for that period, of the \*cost-free debt capital of the entity. The result of this step is the **adjusted average debt**.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (3) The entity's \*adjusted average debt does not exceed its \*maximum allowable debt if the adjusted average debt is nil or a negative amount.
- (4) For the purposes of determining:
- (a) the \*maximum allowable debt for the period mentioned in subsection (1); and
  - (b) the amount of each \*debt deduction to be disallowed;
- sections 820-90 to 820-115 apply in relation to that entity and that period with the modifications set out in the following table:

<b>Modifications of sections 820-90 to 820-115</b>		
<b>Item</b>	<b>Provisions</b>	<b>Modifications</b>
1	Sections 820-90 to 820-115	A reference to an income year is taken to be a reference to that period
2	Section 820-115	A reference to subsection 820-85(1) is taken to be a reference to subsection (1) of this section
3	Section 820-115	<p><b>adjusted average debt</b> is taken to have the meaning given by subsection (2) of this section</p> <p><b>average debt</b> is taken to be the sum of:</p> <ul style="list-style-type: none"> <li>(a) the average value, for that period, of the entity's *debt capital that is covered by step 1 of the method statement in subsection (2) of this section; and</li> <li>(b) the average value, for that period, of the entity's *cost-free debt capital that is covered by step 5 of that method statement;</li> </ul> <p>(disregarding any amount that is attributable to the entity's *overseas permanent establishments in working out the average values).</p>

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Subdivision 820-C—Thin capitalisation rules for inward investing entities (non-ADI)

### Guide to Subdivision 820-C

#### 820-180 What this Subdivision is about

This Subdivision sets out the thin capitalisation rules that apply to a foreign entity or a foreign controlled Australian entity that is not an authorised deposit-taking institution (an **ADI**). These rules deal with the following matters:

- how to work out the entity's maximum allowable debt for an income year;
- how all or a part of the debt deductions claimed by the entity may be disallowed if the maximum allowable debt is exceeded;
- how to apply these rules to a period that is less than an income year.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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820-220 Amount of debt deduction disallowed

820-225 Application to part year periods

**Operative provisions****820-185 Thin capitalisation rule for inward investing entities (non-ADI)***Thin capitalisation rule*

- (1) This subsection disallows all or a part of each \*debt deduction of an entity for an income year if:
- (a) the entity is an \*inward investing entity (non-ADI) for that year (see subsection (2)), but is not also an \*outward investing entity (non-ADI) (see section 820-85) for all or any part of that year; and
  - (b) for that year, the entity's \*adjusted average debt (see subsection (3)) exceeds its \*maximum allowable debt (see section 820-190).

Note 1: This Subdivision does not apply if the total debt deductions of that entity and all its associate entities for that year are \$2 million or less, see section 820-35.

Note 2: To work out the amount to be disallowed, see section 820-220.

Note 3: For the rules that apply to an entity that is an outward investing entity (non-ADI) as well as an inward investing entity (non-ADI), see Subdivision 820-B.

Note 4: For the rules that apply to an entity that is an inward investing entity (non-ADI) for only a part of an income year, see section 820-225 in conjunction with subsection (2) of this section.

Note 5: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

Note 6: A consolidated group or MEC group may be an inward investing entity (non-ADI) to which this Subdivision applies: see Subdivisions 820-FA and 820-FB.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 820-185

*Inward investing entity (non-ADI)*

- (2) The entity is an ***inward investing entity (non-ADI)*** for a period that is all or a part of an income year if, and only if, it is:
- (a) an \*inward investment vehicle (general) for that period (as set out in item 1 of the following table); or
  - (b) an \*inward investment vehicle (financial) for that period (as set out in item 2 of that table); or
  - (c) an \*inward investor (general) for that period (as set out in item 3 of that table); or
  - (d) an \*inward investor (financial) for that period (as set out in item 4 of that table).

<b>Inward investing entity (non-ADI)</b>			
<b>Item</b>	<b>If the entity is a:</b>	<b>and the entity:</b>	<b>the entity is an:</b>
1	*foreign controlled Australian entity throughout a period that is all or a part of an income year	is not a *financial entity, nor an *ADI, at any time during that period	<b><i>inward investment vehicle (general)</i></b> for that period
2	*foreign controlled Australian entity throughout a period that is all or a part of an income year	is a *financial entity throughout that period	<b><i>inward investment vehicle (financial)</i></b> for that period
3	*foreign entity throughout a period that is all or a part of an income year	is not a *financial entity, nor an *ADI, at any time during that period	<b><i>inward investor (general)</i></b> for that period
4	*foreign entity throughout a period that is all or a part of an income year	is a *financial entity throughout that period	<b><i>inward investor (financial)</i></b> for that period

Note 1: To determine whether an entity is a foreign controlled Australian entity, see Subdivision 820-H.

Note 2: The rules that apply to these 4 types of entities are different in some instances. For example, see sections 820-195 to 820-210.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Note 3: An entity covered by item 3 or 4 of the table may be required to keep certain records, see Subdivision 820-L.

*Adjusted average debt*

- (3) The entity's **adjusted average debt** for an income year is the result of applying the method statement in this subsection.

*Method statement*

- Step 1. Work out the average value, for that year (the **relevant year**), of all the \*debt capital of the entity that gives rise to \*debt deductions of the entity for that or any other income year.
- Step 2. Reduce the result of step 1 by the average value, for the relevant year, of:
- (a) if the entity is an \*inward investment vehicle (general) or an \*inward investment vehicle (financial) for that year—all the \*associate entity debt of the entity; or
  - (b) if the entity is an \*inward investor (general) or an \*inward investor (financial) for that year—all the associate entity debt of the entity, to the extent that it is attributable to the entity's \*Australian permanent establishments.
- Step 3. If the entity is a \*financial entity throughout the relevant year, add to the result of step 2 the average value, for the relevant year, of the entity's \*borrowed securities amount.
- Step 4. Add to the result of step 3 the average value, for the relevant year, of the \*cost-free debt capital of the entity. The result of this step is the **adjusted average debt**.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-190

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Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

- (4) The entity's \*adjusted average debt does not exceed its \*maximum allowable debt if the adjusted average debt is nil or a negative amount.

**820-190 Maximum allowable debt**

- (1) The entity's *maximum allowable debt* for an income year is the greatest of the following amounts:
- (a) the \*safe harbour debt amount;
  - (b) the \*arm's length debt amount;
  - (c) unless subsection (2) applies to the entity—the \*worldwide gearing debt amount.

Note 1: The safe harbour debt amount differs depending on whether the entity is an inward investment vehicle (general), inward investment vehicle (financial), inward investor (general) or inward investor (financial), see sections 820-195 to 820-215.

Note 2: The worldwide gearing debt amount differs depending on whether the entity is an inward investment vehicle (general), inward investment vehicle (financial), inward investor (general) or an inward investor (financial), see sections 820-216 to 820-219.

*Entities that are not eligible for the worldwide gearing debt amount*

- (2) This subsection applies to an entity, if:
- (a) the entity has \*statement worldwide equity, or \*statement worldwide assets, of nil or a negative amount; or
  - (b) \*audited consolidated financial statements for the entity for the income year do not exist; or
  - (c) the result of applying the following formula is greater than 0.5:

$$\frac{\text{Average Australian assets of the entity}}{\text{*Statement worldwide assets of the entity for the income year}}$$

where:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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***average Australian assets:***

- (a) of an \*Australian entity—is the average value, for the statement period mentioned in subsection (3), of all the assets of the entity, other than:
    - (i) any \*debt interests held by the entity, to the extent to which any value of the interests is all or a part of the \*controlled foreign entity debt of the entity; or
    - (ii) any \*equity interests or debt interests held by the entity, to the extent to which any value of the interests is all or a part of the \*controlled foreign entity equity of the entity; and
  - (b) of a \*foreign entity—is the average value, for the statement period mentioned in subsection (3), of all the assets of the entity that are:
    - (i) located in Australia; or
    - (ii) attributable to the entity's \*Australian permanent establishments; or
    - (iii) debt interests held by the entity, that were \*issued by an \*Australian entity and are \*on issue; or
    - (iv) equity interests held by the entity in an \*Australian entity.
- (3) For the purposes of the definition of ***average Australian assets*** in subsection (2) the statement period is the period for which the \*audited consolidated financial statements for the entity for the income year have been prepared.
- (4) For the purposes of the formula in paragraph (2)(c), if:
- (a) an amount is included in \*statement worldwide assets in respect of an asset; and
  - (b) the asset was acquired, held or otherwise dealt with by an entity for a purpose (other than an incidental purpose) that included ensuring that subsection (2) does not apply to an entity; and
  - (c) as a result of the acquisition, holding or dealing with of the asset, the amount included in statement worldwide assets

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-195

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exceeds the amount (including nil) that would otherwise be so included;

apply the amount of the excess to reduce statement worldwide assets (or statement worldwide assets as reduced by a previous application of this subsection).

**820-195 Safe harbour debt amount—inward investment vehicle (general)**

If the entity is an \*inward investment vehicle (general) for the income year, the **safe harbour debt amount** is the result of applying the method statement in this section.

*Method statement*

- Step 1. Work out the average value, for the income year, of all the assets of the entity.
- Step 1A. Reduce the result of step 1 by the average value, for that year, of all the \*excluded equity interests in the entity.
- Step 2. Reduce the result of step 1A by the average value, for that year, of all the \*associate entity debt of the entity.
- Step 3. Reduce the result of step 2 by the average value, for that year, of all the \*associate entity equity of the entity.
- Step 4. Reduce the result of step 3 by the average value, for that year, of all the \*non-debt liabilities of the entity. If the result of this step is a negative amount, it is taken to be nil.
- Step 5. Multiply the result of step 4 by <sup>3</sup>/<sub>5</sub>.
- Step 6. Add to the result of step 5 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **safe harbour debt amount**.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 820-200**

Example: ALWZ Ltd, a company that is an Australian entity, has an average value of assets of \$100 million.

The average values of its excluded equity interests, associate entity debt, associate entity equity and non-debt liabilities are \$5 million, \$10 million, \$5 million and \$5 million respectively. Deducting these amounts from the result of step 1 (through applying steps 1A to 4) leaves \$75 million. Multiplying \$75 million by  $\frac{3}{5}$  results in \$45 million. As the average value of the company's associate entity excess amount is \$2 million, the safe harbour debt amount is therefore \$47 million.

### **820-200 Safe harbour debt amount—inward investment vehicle (financial)**

- (1) If the entity is an \*inward investment vehicle (financial) for the income year, the **safe harbour debt amount** is the lesser of the following amounts:
  - (a) the \*total debt amount (worked out under subsection (2));
  - (b) the \*adjusted on-lent amount (worked out under subsection (3)).

However, if the 2 amounts are equal, it is the total debt amount.

#### *Total debt amount*

- (2) The **total debt amount** is the result of the method statement in this subsection.

#### *Method statement*

- Step 1. Work out the average value, for the income year, of all the assets of the entity.
- Step 1A. Reduce the result of step 1 by the average value, for that year, of all the \*excluded equity interests in the entity.
- Step 2. Reduce the result of step 1A by the average value, for that year, of all the \*associate entity debt of the entity.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- Step 3. Reduce the result of step 2 by the average value, for that year, of all the \*associate entity equity of the entity.
- Step 4. Reduce the result of step 3 by the average value, for that year, of all the \*non-debt liabilities of the entity.
- Step 5. Reduce the result of step 4 by the average value, for that year, of the entity's \*zero-capital amount. If the result of this step is a negative amount, it is taken to be nil.
- Step 6. Multiply the result of step 5 by  $^{15}/_{16}$ .
- Step 7. Add to the result of step 6 the average value, for that year, of the entity's \*zero-capital amount.
- Step 8. Add to the result of step 7 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **total debt amount**.

Example: KJW Finance Pty Ltd, a company that is an Australian entity, has an average value of assets of \$120 million.

The average values of its excluded equity interests, associate entity debt, associate entity equity, its non-debt liabilities and its zero-capital amount are \$5 million, \$5 million, \$3 million, \$2 million and \$5 million respectively. Deducting these amounts from the result of step 1 (through applying steps 1A to 5) leaves \$100 million. Multiplying \$100 million by  $^{15}/_{16}$  results in \$93.75 million. Adding the zero-capital amount of \$5 million to \$93.75 million results in \$98.75 million. As the company does not have any associate entity excess amount, the total debt amount is therefore \$98.75 million.

*Adjusted on-lent amount*

- (3) The **adjusted on-lent amount** is the result of applying the method statement in this subsection.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



*Method statement*

- Step 1. Work out the average value, for the income year, of all the assets of the entity.
- Step 1A. Reduce the result of step 1 by the average value, for that year, of all the \*excluded equity interests in the entity.
- Step 2. Reduce the result of step 1A by the average value, for that year, of all the \*associate entity equity of the entity.
- Step 3. Reduce the result of step 2 by the average value, for that year, of all the \*non-debt liabilities of the entity.
- Step 4. Reduce the result of step 3 by the amount (the **average on-lent amount**) which is the average value, for that year, of the entity's \*on-lent amount. If the result of this step is a negative amount, it is taken to be nil.
- Step 5. Multiply the result of step 4 by  $\frac{3}{5}$ .
- Step 6. Add to the result of step 5 the average on-lent amount.
- Step 7. Reduce the result of step 6 by the average value, for that year, of all the \*associate entity debt of the entity.
- Step 8. Add to the result of step 7 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **adjusted on-lent amount**.

Example: KJW Finance Pty Ltd, a company that is an Australian entity, has an average value of assets of \$120 million.

The average values of its excluded equity interests, associate entity equity, non-debt liabilities and on-lent amount are \$5 million, \$3 million, \$2 million and \$35 million respectively. Deducting these amounts from the result of step 1 (through applying steps 1A to 4) leaves \$75 million. Multiplying \$75 million by  $\frac{3}{5}$  results in \$45 million. Adding the average on-lent amount of \$35 million results in \$80 million. Reducing \$80 million by the associate entity debt amount

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-205

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of \$5 million results in \$75 million. As the company does not have any associate entity excess amount, the adjusted on-lent amount is therefore \$75 million.

**820-205 Safe harbour debt amount—inward investor (general)**

If the entity is an \*inward investor (general) for the income year, the **safe harbour debt amount** is the result of applying the method statement in this section.

*Method statement*

- Step 1. Work out the average value, for the income year, of all of the following assets of the entity (the **Australian investments**):
- (a) assets that are attributable to the entity's \*Australian permanent establishments;
  - (b) other assets that are held for the purposes of producing the entity's assessable income.
- Step 1A. Reduce the result of step 1 by the average value, for that year, of all the \*excluded equity interests in the entity.
- Step 2. Reduce the result of step 1A by the average value, for that year, of all the \*associate entity debt of the entity that has arisen because of the Australian investments.
- Step 3. Reduce the result of step 2 by the average value, for that year, of all the \*associate entity equity of the entity that has arisen because of the Australian investments.
- Step 4. Reduce the result of step 3 by the average value, for that year, of all the \*non-debt liabilities of the entity that have arisen because of the Australian investments. If the result of this step is a negative amount, it is taken to be nil.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 820-210

Step 5. Multiply the result of step 4 by  $\frac{3}{5}$ .

Step 6. Add to the result of step 5 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **safe harbour debt amount**.

Example: RJ Corporation is a company that is not an Australian entity. The average value of its Australian investments is \$100 million.

The average value of its relevant excluded equity interests, associate entity debt, associate entity equity and non-debt liabilities is \$5 million, \$10 million, \$5 million and \$5 million respectively. Deducting those amounts from the result of step 1 leaves \$75 million. Multiplying \$75 million by  $\frac{3}{5}$  results in \$45 million. As the company does not have any associate entity excess amount, the safe harbour debt amount is therefore \$45 million.

**820-210 Safe harbour debt amount—inward investor (financial)**

- (1) If the entity is an \*inward investor (financial) for that year, the **safe harbour debt amount** is the lesser of the following amounts:
- (a) the \*total debt amount (worked out under subsection (2));
  - (b) the \*adjusted on-lent amount (worked out under subsection (3)).

However, if the 2 amounts are equal, it is the total debt amount.

*Total debt amount*

- (2) The **total debt amount** is the result of applying the method statement in this subsection.

*Method statement*

Step 1. Work out the average value, for the income year, of all of the following assets of the entity (the **Australian investments**):

- (a) assets that are attributable to the entity's \*Australian permanent establishments;

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) other assets that are held for the purposes of producing the entity's assessable income.

Step 1A. Reduce the result of step 1 by the average value, for that year, of all the \*excluded equity interests in the entity.

Step 2. Reduce the result of step 1A by the average value, for that year, of all the \*associate entity debt of the entity that has arisen because of the Australian investments.

Step 3. Reduce the result of step 2 by the average value, for that year, of all the \*associate entity equity of the entity that has arisen because of the Australian investments.

Step 4. Reduce the result of step 3 by the average value, for that year, of all the \*non-debt liabilities of the entity that have arisen because of the Australian investments.

Step 5. Reduce the result of step 4 by the average value, for that year, of the entity's \*zero-capital amount that has arisen because of the Australian investments. If the result of this step is a negative amount, it is taken to be nil.

Step 6. Multiply the result of step 5 by <sup>15</sup>/<sub>16</sub>.

Step 7. Add to the result of step 6 the average value, for that year, of the entity's \*zero-capital amount that has arisen because of the Australian investments.

Step 8. Add to the result of step 7 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **total debt amount**.

Example: FXS Financial SA is a company that is not an Australian entity. The average value of its Australian investments is \$120 million.

The average value of its relevant excluded equity interests, associate entity debt, associate entity equity, non-debt liabilities and zero-capital amount are \$5 million, \$5 million, \$2 million, \$3 million and \$5

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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million respectively. Deducting those amounts from the result of step 1 (through applying steps 1A to 5) leaves \$100 million. Multiplying \$100 million by  $\frac{15}{16}$  results in \$93.75 million. Adding the average zero-capital amount of \$5 million results in \$98.75 million. As the company does not have any associate entity excess amount, the total debt amount is therefore \$98.75 million.

*Adjusted on-lent amount*

- (3) The ***adjusted on-lent amount*** is the result of applying the method statement in this subsection.

*Method statement*

- Step 1. Work out the average value, for the income year, of all of the following assets of the entity (the ***Australian investments***):
- (a) assets that are attributable to the entity's  
\*Australian permanent establishments;
  - (b) other assets that are held for the purposes of  
producing the entity's assessable income.
- Step 1A. Reduce the result of step 1 by the average value, for that year, of all the \*excluded equity interests in the entity.
- Step 2. Reduce the result of step 1A by the average value, for that year, of all the \*associate entity equity of the entity that has arisen because of the Australian investments.
- Step 3. Reduce the result of step 2 by the average value, for that year, of all the \*non-debt liabilities of the entity that has arisen because of the Australian investments.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- Step 4. Reduce the result of step 3 by the amount (the ***average on-lent amount***) which is the average value, for that year, of the \*on-lent amount of the entity (to the extent that it is the value of all or a part of the Australian investments). If the result of this step is a negative amount, it is taken to be nil.
- Step 5. Multiply the result of step 4 by  $\frac{3}{5}$ .
- Step 6. Add to the result of step 5 the average on-lent amount.
- Step 7. Reduce the result of step 6 by the average value, for that year, of all the \*associate entity debt of the entity that has arisen because of the Australian investments. If the result of this step is a negative amount, it is taken to be nil.
- Step 8. Add to the result of step 7 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the ***adjusted on-lent amount***.

Example: FXS Financial SA is a company that is not an Australian entity. The average value of its Australian investments is \$120 million.

The average value of its relevant excluded equity interests, associate entity equity, non-debt liabilities and on-lent amount are \$5 million, \$2 million, \$3 million and \$35 million respectively. Deducting those amounts from the result of step 1 (through applying steps 1A to 4) leaves \$75 million. Multiplying \$75 million by  $\frac{3}{5}$  results in \$45 million. Adding the average on-lent amount of \$35 million results in \$80 million. Reducing the result of step 6 by the associate entity debt amount of \$5 million results in \$75 million. As the company does not have any associate entity excess amount, the adjusted on-lent amount is therefore \$75 million.

### 820-215 Arm's length debt amount

- (1) The ***arm's length debt amount*** is a notional amount that, having regard to the factual assumptions set out in subsection (2) and the relevant factors mentioned in subsection (3), would satisfy both paragraphs (a) and (b):

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (a) the amount represents a notional amount of \*debt capital that:
  - (i) the entity would reasonably be expected to have throughout the income year; and
  - (ii) would give rise to an amount of \*debt deductions of the entity for that or any other income year; and
  - (iii) would be attributable to the entity's Australian business as mentioned in subsection (2);
- (b) commercial lending institutions that were not \*associates of the entity (the ***notional lenders***) would reasonably be expected to have entered into \*schemes that would:
  - (i) give rise to \*debt interests that constituted that notional amount of debt capital of the entity; and
  - (ii) provide for terms and conditions for the debt interests that would reasonably be expected to have applied if the entity and the notional lenders had been dealing at \*arm's length with each other throughout the income year mentioned in subparagraph (1)(a)(i).

Note: The entity must keep records in accordance with section 820-980 if the entity works out an amount under this section.

#### *Factual assumptions*

- (2) Irrespective of what actually happened during that year, the following assumptions must be made in working out that amount:
  - (a) the entity's commercial activities in connection with Australia (the ***Australian business***) during that year:
    - (i) if the entity is an \*inward investment vehicle (general) or \*inward investment vehicle (financial) for that year—do not include the holding of any \*associate entity debt; and
    - (ii) if the entity is an \*inward investor (general) or \*inward investor (financial) for that year—consist only of its Australian investments (within the meaning of section 820-205 or 820-210, as appropriate), other than the holding of any associate entity debt that is attributable to its \*Australian permanent establishments;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the entity had carried on the Australian business that it actually carried on during that year;
- (c) the nature of the entity's assets and liabilities (to the extent that they are attributable to the Australian business) had been as they were during that year;
- (d) except as stated in paragraph (1)(b) and paragraphs (e), (f) and (g) of this subsection, the entity had carried on the Australian business in the same circumstances as what actually existed during that year;
- (e) any guarantee, security or other form of credit support provided to the entity in relation to the Australian business during that year:
  - (i) by its \*associates; or
  - (ii) by the use of assets of the entity that are attributable to the entity's overseas permanent establishments;is taken not to have been received by the entity;
- (f) the entity's only activities during that year were the Australian business;
- (g) the entity's only assets and liabilities during that year were those referred to in paragraph (c) of this subsection.

However, the assumptions set out in paragraphs (f) and (g) of this subsection are not to be made in taking into account the relevant factors mentioned in subsection (3).

*Relevant factors*

- (3) On the basis of the factual assumptions set out in subsection (2), the following factors must be taken into account in determining whether or not an amount satisfies paragraphs (1)(a) and (b):
  - (a) the functions performed, the assets used, and the risks assumed, by the entity in relation to the Australian business throughout that year;
  - (b) the terms and conditions of the \*debt capital that the entity actually had in relation to the Australian business throughout that year;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (c) the nature of, and title to, any assets of the entity attributable to the Australian business that were available to the entity throughout that year as security for its debt capital for that business;
- (d) the purposes for which \*schemes for debt capital had been actually entered into by the entity in relation to the Australian business throughout that year;
- (e) the entity's capacity to meet all its liabilities in relation to the Australian business (whether during that year or at any other time);
- (f) the profit of the entity (within the meaning of the \*accounting standards), and the return on its capital, in relation to the Australian business (whether during that year or at any other time);
- (g) the debt to equity ratios of the following throughout that year:
  - (i) the entity;
  - (ii) the entity in relation to the Australian business;
  - (iii) each of the entity's \*associate entities that engage in commercial activities similar to the Australian business;
  - (iv) each other entity in which the entity has a direct or indirect interest;
- (h) the commercial practices adopted by independent parties dealing with each other at \*arm's length in the industry in which the entity carries on the Australian business throughout that year (whether in Australia or in comparable markets elsewhere);
- (i) the general state of the Australian economy throughout that year;
- (j) all of the above factors existing at the time when the entity last entered into a \*scheme that gave rise to an actual \*debt interest attributable to the Australian business that remains \*on issue throughout that year;
- (k) any other factors which are specified in the regulations made for the purposes of this section, including factors that are specific to an \*inward investment vehicle (general), an

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-216

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\*inward investment vehicle (financial), an \*inward investor (general) or an \*inward investor (financial).

*Commissioner's power*

- (4) If the Commissioner considers an amount worked out by the entity under this section does not appropriately take into account the factual assumptions and the relevant factors, the Commissioner may substitute another amount that the Commissioner considers better reflects those assumptions and factors.

**820-216 Worldwide gearing debt amount—inward investment vehicle (general)**

If the entity is an \*inward investment vehicle (general) for the income year, and is not also an \*outward investor (general) for all or any part of that year, the **worldwide gearing debt amount** is the result of applying the method statement in this section.

*Method statement*

- Step 1. Divide the entity's \*statement worldwide debt for the income year by the entity's \*statement worldwide equity for that year.
- Step 2. Add 1 to the result of step 1.
- Step 3. Divide the result of step 1 by the result of step 2.
- Step 4. Multiply the result of step 3 in this method statement by the result of step 4 in the method statement in section 820-195.
- Step 5. Add to the result of step 4 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **worldwide gearing debt amount**.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 820-217**

Example: SJP Limited, a company that is an Australian entity, has a worldwide parent entity in Japan. SJP Limited has statement worldwide debt of \$120 million and statement worldwide equity of \$40 million. The result of applying step 1 is therefore 3. Dividing 3 by 4 (through applying steps 2 and 3) and multiplying the result by \$75 million (which is the result of step 4 of the method statement in section 820-195) equals \$56.25 million. As the average value of the company's associate entity excess amount is \$4 million, the worldwide gearing debt amount is therefore \$60.25 million.

### **820-217 Worldwide gearing debt amount—inward investment vehicle (financial)**

If the entity is an \*inward investment vehicle (financial) for the income year, and is not also an \*outward investor (financial) for all or any part of that year, the **worldwide gearing debt amount** is the result of applying the method statement in this section.

#### *Method statement*

- Step 1. Divide the entity's \*statement worldwide debt for the income year by the entity's \*statement worldwide equity for that year.
- Step 2. Add 1 to the result of step 1.
- Step 3. Divide the result of step 1 by the result of step 2.
- Step 4. Multiply the result of step 3 in this method statement by the result of step 5 in the method statement in subsection 820-200(2).
- Step 5. Add to the result of step 4 the average value, for that year, of the entity's \*zero-capital amount.
- Step 6. Add to the result of step 5 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **worldwide gearing debt amount**.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Example: RGR Limited, a company that is an Australian entity, has a worldwide parent entity in France. RGR Limited has statement worldwide debt of \$90 million and statement worldwide equity of \$30 million. The result of applying step 1 is therefore 3. Dividing 3 by 4 (through applying steps 2 and 3) and multiplying the result by \$100 million (which is the result of step 5 of the method statement in subsection 820-200(2)) equals \$75 million. The zero capital amount is \$5 million. Adding that amount to \$75 million results in \$80 million. As the company does not have any associate entity excess amount, the worldwide gearing debt amount is therefore \$80 million.

### 820-218 Worldwide gearing debt amount—inward investor (general)

If the entity is an \*inward investor (general) for the income year, the **worldwide gearing debt amount** is the result of applying the method statement in this section.

#### *Method statement*

- Step 1. Divide the entity's \*statement worldwide debt for the income year by the entity's \*statement worldwide equity for that year.
- Step 2. Add 1 to the result of step 1.
- Step 3. Divide the result of step 1 by the result of step 2.
- Step 4. Multiply the result of step 3 in this method statement by the result of step 4 in the method statement in section 820-205.
- Step 5. Add to the result of step 4 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **worldwide gearing debt amount**.

Example: MLO Limited, a company that is not an Australian entity, has investments in Australia. MLO Limited has statement worldwide debt of \$120 million and statement worldwide equity of \$40 million.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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The result of applying step 1 is therefore 3. Dividing 3 by 4 (through applying steps 2 and 3) and multiplying the result by \$75 million (which is the result of step 4 of the method statement in section 820-205) equals \$56.25 million. As the average value of the company's associate entity excess amount is \$4 million, the worldwide gearing debt amount is therefore \$60.25 million.

### **820-219 Worldwide gearing debt amount—inward investor (financial)**

If the entity is an \*inward investor (financial) for the income year, the **worldwide gearing debt amount** is the result of applying the method statement in this section.

#### *Method statement*

- Step 1. Divide the entity's \*statement worldwide debt for the income year by the entity's \*statement worldwide equity for that year.
- Step 2. Add 1 to the result of step 1.
- Step 3. Divide the result of step 1 by the result of step 2.
- Step 4. Multiply the result of step 3 in this method statement by the result of step 5 in the method statement in subsection 820-210(2).
- Step 5. Add to the result of step 4 the average value, for that year, of the entity's \*zero-capital amount that has arisen because of the Australian investments mentioned in step 1 of the method statement in subsection 820-210(2).
- Step 6. Add to the result of step 5 the average value, for that year, of the entity's \*associate entity excess amount. The result of this step is the **worldwide gearing debt amount**.

Example: MSR Limited, a company that is not an Australian entity, has investments in Australia. MSR Limited has statement worldwide debt

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 820-220

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of \$90 million and statement worldwide equity of \$30 million. The result of applying step 1 is therefore 3. Dividing 3 by 4 (through applying steps 2 and 3) and multiplying the result by \$100 million (which is the result of step 5 of the method statement in subsection 820-210(2)) equals \$75 million. The zero-capital amount is \$5 million. Adding that amount to \$75 million results in \$80 million. As the company does not have any associate entity excess amount, the worldwide gearing debt amount is therefore \$80 million.

### 820-220 Amount of debt deduction disallowed

The amount of \*debt deduction disallowed under subsection 820-185(1) is worked out using the following formula:

$$\text{Debt deduction} \times \frac{\text{Excess debt}}{\text{Average debt}}$$

where:

**average debt** means the sum of:

- (a) the average value, for the income year, of the entity's \*debt capital that is covered by step 1 of the method statement in subsection 820-185(3); and
- (b) the average value, for that year, of the entity's \*cost-free debt capital that is covered by step 4 of that method statement.

**debt deduction** means each \*debt deduction of the entity for that year.

**excess debt** means the amount by which the \*adjusted average debt (see subsection 820-185(3)) exceeds the entity's \*maximum allowable debt for that year.

Note: The disallowed amount also does not form part of the cost base of a CGT asset. See section 110-54.

### 820-225 Application to part year periods

- (1) This subsection disallows all or a part of each \*debt deduction of an entity for an income year that is an amount incurred by the entity during a period that is a part of that year, if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) the entity is an \*inward investing entity (non-ADI) for that period, but is not also an \*outward investing entity (non-ADI) for all or any part of that period; and
- (b) the entity's \*adjusted average debt for that period exceeds the entity's \*maximum allowable debt for that period.

Note: To determine whether an entity is an inward investing entity (non-ADI) for a period, see subsection 820-185(2).

- (2) The entity's **adjusted average debt** for that period is the result of applying the method statement in this subsection.

*Method statement*

- Step 1. Work out the average value, for that period, of all the \*debt capital of the entity that gives rise to \*debt deductions of the entity for that or any other income year.
- Step 2. Reduce the result of step 1 by the average value, for that period, of:
  - (a) if the entity is an \*inward investment vehicle (general) or an \*inward investment vehicle (financial) for that period—all the \*associate entity debt of the entity; or
  - (b) if the entity is an \*inward investor (general) or an \*inward investor (financial) for that period—all the associate entity debt of the entity, to the extent that it is attributable to the entity's \*Australian permanent establishments.
- Step 3. If the entity is a \*financial entity throughout that period, add to the result of step 2 the average value, for that period, of the entity's \*borrowed securities amount.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-225

Step 4. Add to the result of step 3 the average value, for that period, of the \*cost-free debt capital of the entity. The result of this step is the **adjusted average debt**.

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

(2A) The entity's \*adjusted average debt does not exceed its \*maximum allowable debt if the adjusted average debt is nil or a negative amount.

(3) For the purposes of determining:

(a) the \*maximum allowable debt for the period mentioned in subsection (1); and

(b) the amount of each \*debt deduction to be disallowed;

sections 820-190 to 820-220 apply in relation to that entity and that period with the modifications set out in the following table:

Modifications of sections 820-190 to 820-220		
Item	Provisions	Modifications
1	Sections 820-190 to 820-220	A reference to an income year is taken to be a reference to that period
2	Section 820-220	A reference to subsection 820-185(1) is taken to be a reference to subsection (1) of this section
3	Section 820-220	<b>adjusted average debt</b> is taken to have the meaning given by subsection (2) of this section <b>average debt</b> is taken to be the sum of: (a) the average value, for that period, of the entity's *debt capital that is covered by step 1 of the method statement in subsection (2) of this section; and (b) the average value, for that period, of the entity's *cost-free debt capital that is covered by step 4 of that method statement.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



**Subdivision 820-D—Thin capitalisation rules for outward investing entities (ADI)****Guide to Subdivision 820-D****820-295 What this Subdivision is about**

This Subdivision sets out the thin capitalisation rules that apply to an entity that is both an authorised deposit-taking institution (an **ADI**) and an Australian entity that has certain types of overseas investments. These rules deal with the following matters:

- how to work out the entity's minimum capital amount for an income year;
- how all or a part of the debt deductions claimed by the entity may be disallowed if the minimum capital amount is not reached;
- how to apply these rules to a period that is less than an income year.

**Table of sections****Operative provisions**

820-300	Thin capitalisation rule for outward investing entities (ADI)
820-305	Minimum capital amount
820-310	Safe harbour capital amount
820-315	Arm's length capital amount
820-320	Worldwide capital amount
820-325	Amount of debt deduction disallowed
820-330	Application to part year periods

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-300

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## Operative provisions

### 820-300 Thin capitalisation rule for outward investing entities (ADI)

#### *Thin capitalisation rule*

- (1) This subsection disallows all or a part of each \*debt deduction of an entity for an income year (to the extent that it is not attributable to an \*overseas permanent establishment of the entity) if, for that year:
- (a) the entity is an \*outward investing entity (ADI) (see subsection (2)); and
  - (b) the entity's \*adjusted average equity capital (see subsection (3)) is less than the entity's \*minimum capital amount (see section 820-305).

Note 1: This Subdivision does not apply if the total debt deductions of that entity and all its associate entities for that year are \$2 million or less, see section 820-35.

Note 2: To work out the amount to be disallowed, see section 820-325.

Note 3: For the rules that apply to an entity that is an outward investing entity (ADI) for only part of an income year, see section 820-330 in conjunction with subsection (2) of this section.

Note 4: A consolidated group or MEC group may be an outward investing entity (ADI) to which this Subdivision applies: see Subdivisions 820-FA and 820-FB.

#### *Outward investing entity (ADI)*

- (2) The entity is an **outward investing entity (ADI)** for a period that is all or a part of an income year if, and only if, throughout that period, the entity is an \*ADI to which at least one of the following paragraphs applies:
- (a) the entity is an \*Australian controller of at least one \*Australian controlled foreign entity (not necessarily the same Australian controlled foreign entity throughout that period);

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the entity is an \*Australian entity that carries on a \*business at or through at least one \*overseas permanent establishment (not necessarily the same permanent establishment throughout that period);
- (c) the entity is:
  - (i) an Australian entity; and
  - (ii) an \*associate entity of another entity that is an \*outward investing entity (non-ADI) or an \*outward investing entity (ADI) for that period.

Note: To determine whether an entity is an Australian controller of an Australian controlled foreign entity, see Subdivision 820-H.

*Adjusted average equity capital*

- (3) The entity's **adjusted average equity capital** for an income year is:
  - (a) the average value, for that year, of all the \*ADI equity capital of the entity (other than ADI equity capital attributable to its \*overseas permanent establishments); minus
  - (b) the average value, for that year, of all the \*controlled foreign entity equity of the entity (other than controlled foreign entity equity attributable to its overseas permanent establishments).
- (4) For the purposes of paragraph (3)(a), treat treasury shares (within the meaning of \*accounting standard AASB 132) in the entity as included in the \*ADI equity capital of the entity, to the extent that those shares are part of the entity's eligible tier 1 capital (within the meaning of the \*prudential standards).

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

## **820-305 Minimum capital amount**

The entity's **minimum capital amount** for an income year is the least of the following amounts:

- (a) the \*safe harbour capital amount;
- (b) the \*arm's length capital amount;
- (c) the \*worldwide capital amount.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 820-310

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Note: The entity cannot use the worldwide capital amount if the entity is also a foreign controlled Australian entity throughout that year, see section 820-320.

### 820-310 Safe harbour capital amount

- (1) The *safe harbour capital amount* is the result of applying the method statement in this section.

#### *Method statement*

Step 1. Work out the average value, for the income year, of all the entity's:

- (aa) \*risk-weighted assets; and
- (ab) intangible assets comprising capitalised software expenses;

that are attributable to none of the following:

- (a) the entity's \*overseas permanent establishments;
- (b) assets comprised by the \*controlled foreign entity equity of the entity (other than controlled foreign entity equity attributable to the entity's overseas permanent establishments);
- (c) assets for which \*prudential capital deductions must be made by the entity (other than prudential capital deductions attributable to the entity's overseas permanent establishments).

Step 2. Multiply the result of step 1 by 6%.

Step 3. Add to the result of step 2 the average value, for that year, of all the \*tier 1 prudential capital deductions for the entity, to the extent that they are not attributable to:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 820-310

- (a) any of the entity's \*overseas permanent establishments; or
  - (b) any \*Australian controlled foreign entities of which the entity is an \*Australian controller; or
  - (c) any of the entity's goodwill or intangible assets which relate to the excess mentioned in paragraph 5.3 of \*accounting standard AASB 1038, as issued on 17 November 1998, to the extent that the excess is referable to \*VBIF; or
- Note: Paragraph 5.3 of that accounting standard applies to any excess of the net market values of an interest in a subsidiary over the net amount of that subsidiary's assets and liabilities.
- (d) any of the entity's intangible assets comprising capitalised software expenses.

The result of this step is the *safe harbour capital amount*.

Example: The Southern Cross Bank is an Australian bank that carries on its banking business through its overseas permanent establishments and through foreign entities that it controls. For the income year, its average value of risk-weighted assets and intangible assets comprising capitalised software expenses is \$150 million (having discounted those assets that are excluded by step 1) and the average value of its relevant tier 1 prudential capital deductions is \$2 million. Multiplying \$150 million by 6% equals \$9 million, which is the result of step 2. Adding \$2 million to \$9 million equals \$11 million, which is the safe harbour capital amount.

- (2) **VBIF** is the value of business in force at the time of acquisition of the relevant subsidiary (within the meaning of paragraph 5.3 of \*accounting standard AASB 1038, as issued on 17 November 1998) of the entity.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-315

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- (3) \*VBIF is taken to be nil at all times unless the value of VBIF at the time of acquisition of the relevant subsidiary was worked out by an \*actuary according to Australian actuarial practice.

**820-315 Arm's length capital amount**

- (1) The *arm's length capital amount* is a notional amount that, having regard to:
- (a) the factual assumptions set out in subsection (2); and
  - (b) the relevant factors mentioned in subsection (3);
- would represent the minimum amount of \*equity capital that the entity would reasonably be expected to have in carrying on the Australian business mentioned in subsection (2) throughout the income year if, throughout that year:
- (c) the part of the entity carrying on that business had operated as if it were a separate entity; and
  - (d) that separate entity had been dealing at \*arm's length with:
    - (i) the other part of the entity; and
    - (ii) all the \*Australian controlled foreign entities of which the entity is an \*Australian controller.

Note: The entity must keep records in accordance with section 820-980 if the entity works out an amount under this section.

*Factual assumptions*

- (2) Irrespective of what actually happened during that year, the following assumptions must be made in working out that minimum amount:
- (a) the entity's commercial activities in connection with Australia (the *Australian business*) during that year do not include:
    - (i) any \*business carried on by the entity at or through its \*overseas permanent establishments; or
    - (ii) the holding of any \*controlled foreign entity equity;
  - (b) the entity had carried on the Australian business that it actually carried on during that year;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (c) the nature of the entity's assets and liabilities (to the extent that they are attributable to the Australian business) had been as they were during that year;
- (d) except as mentioned in subsection (1), the entity had carried on the Australian business in the same circumstances as what actually existed during that year.

*Relevant factors*

- (3) On the basis of the factual assumptions set out in subsection (2), the following factors must be taken into account in determining that minimum amount:
  - (a) the functions performed, the assets used, and the risks assumed, throughout that year, by:
    - (i) the entity; and
    - (ii) the entity in relation to the Australian business;
  - (b) the credit rating of the entity throughout that year, including the effect of that credit rating on all of the following:
    - (i) the entity's ability to borrow in relation to the Australian business;
    - (ii) the interest rate at which the entity borrowed in relation to that business;
    - (iii) the entity's gross profit margin in relation to that business;
  - (c) the capital ratios of the following throughout that year:
    - (i) the entity;
    - (ii) the entity in relation to the Australian business;
    - (iii) each of the entity's \*associate entities that engage in commercial activities similar to the Australian business;
  - (d) the purposes for which \*schemes for \*debt capital and for \*equity capital had been actually entered into, throughout that year, by:
    - (i) the entity; and
    - (ii) the entity in relation to the Australian business;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-320

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- (e) the profit (within the meaning of the \*accounting standards), and the return on capital, whether during that year or at any other time, of:
  - (i) the entity; and
  - (ii) the entity in relation to the Australian business;
- (f) the commercial practices adopted by independent parties dealing with each other at \*arm's length in the industry in which the entity carries on the Australian business throughout that year (whether in Australia or in comparable markets elsewhere);
- (g) the way in which the entity financed its business (other than the Australian business) throughout that year;
- (h) the general state of the Australian economy throughout that year;
- (i) any other factors which are specified in the regulations made for the purposes of this section.

*Commissioner's power*

- (4) If the Commissioner considers an amount worked out by the entity under this section does not appropriately take into account the factual assumptions and the relevant factors, the Commissioner may substitute another amount that the Commissioner considers better reflects those assumptions and factors.

**820-320 Worldwide capital amount**

- (1) This section only applies if the entity is not also a \*foreign controlled Australian entity throughout the income year.
- (2) The ***worldwide capital amount*** is the result of applying the method statement in this subsection.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Method statement*

- Step 1. Work out the average value, for the income year, of all the \*risk-weighted assets of the entity, other than risk-weighted assets attributable to any of the following:
- (a) the entity's \*overseas permanent establishments;
  - (b) assets comprised by the \*controlled foreign entity equity of the entity;
  - (c) assets for which \*prudential capital deductions must be made by the entity.
- Step 3. Multiply the result of step 1 by the entity's worldwide group capital ratio for that year (see subsection (3)).
- Step 4. Add to the result of step 3 the average value, for that year, of all the \*tier 1 prudential capital deductions for the entity (to the extent that they are not attributable to any of the entity's \*overseas permanent establishments or to any \*Australian controlled foreign entities of which the entity is an \*Australian controller). The result of this step is the **worldwide capital amount**.

Example: Southern Cross Bank has an average value of risk-weighted assets of \$150 million (having discounted those risk-weighted assets that are excluded by step 1) and the average value of its relevant tier 1 prudential capital deductions is \$2 million. The entity's worldwide group capital ratio is 0.0875. Multiplying \$150 million by 0.0875 equals \$13.125 million, which is the result of step 3. Adding that amount to the average value of the relevant tier 1 prudential capital deductions equals \$15.125 million, which is the worldwide capital amount.

*Worldwide group capital ratio*

- (3) The entity's **worldwide group capital ratio** for the income year is the result of applying the method statement in this subsection.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-325

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*Method statement*

- Step 1. Work out the average value, for the income year, of the tier 1 capital (within the meaning of the \*prudential standards) of the consolidated group of which the entity is a member (within the meaning of those standards) in accordance with those standards.
- Step 2. Divide the result of step 1 by the average value, for that year, of the \*risk-weighted assets of that group in accordance with the \*prudential standards. The result is the **worldwide group capital ratio**.

Example: For the Southern Cross Bank, the average value of the tier 1 capital for the relevant consolidated group is \$14 million. Dividing \$14 million by the group's risk weighted assets of \$160 million equals 0.0875, which is the worldwide group capital ratio.

**820-325 Amount of debt deduction disallowed**

The amount of \*debt deduction disallowed under subsection 820-300(1) is worked out using the following formula:

$$\text{Debt deduction} \times \frac{\text{Capital shortfall}}{\text{Average debt}}$$

where:

**average debt** means the average value, for the income year, of all the \*debt capital of the entity that gives rise to \*debt deductions of the entity for that or any other income year (other than any debt capital that is attributable to any of the entity's \*overseas permanent establishments).

**capital shortfall** means the amount by which the \*adjusted average equity capital of the entity for that year (see subsection 820-300(3)) is less than the entity's \*minimum capital amount for that year.

**debt deduction** means each \*debt deduction covered by subsection 820-300(1).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 820-330**

Note: The disallowed amount also does not form part of the cost base of a CGT asset. See section 110-54.

**820-330 Application to part year periods**

- (1) This subsection disallows all or a part of each \*debt deduction of an entity for an income year that is an amount incurred by the entity during a period that is a part of that year (to the extent that it is not attributable to an \*overseas permanent establishment of the entity) if, for that period:

- (a) the entity is an \*outward investing entity (ADI); and
- (b) the \*adjusted average equity capital of the entity is less than the entity's \*minimum capital amount.

Note: To determine whether an entity is an outward investing entity (non-ADI) for that period, see subsection 820-300(2).

- (2) The entity's ***adjusted average equity capital*** for that period is:

- (a) the average value, for that period, of all the \*ADI equity capital of the entity (other than ADI equity capital attributable to any of its \*overseas permanent establishments); minus
- (b) the average value, for that period, of all the \*controlled foreign entity equity of the entity (other than controlled foreign entity equity attributable to any of its overseas permanent establishments).

- (3) For the purposes of determining:

- (a) the entity's \*minimum capital amount for that period; and
- (b) the amount of each \*debt deduction to be disallowed;

sections 820-305 to 820-325 apply in relation to that entity and that period with the modifications set out in the following table:

<b>Modifications of sections 820-305 to 820-325</b>		
<b>Item</b>	<b>Provisions</b>	<b>Modifications</b>
1	Sections 820-305 to 820-325	A reference to an income year is taken to be a reference to that period

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-390

**Modifications of sections 820-305 to 820-325**

Item	Provisions	Modifications
2	Section 820-325	A reference to subsection 820-300(1) is taken to be a reference to subsection (1) of this section
3	Section 820-325	<i>adjusted average equity capital</i> has the meaning given by subsection (2) of this section <i>average debt</i> is taken to be the average value, for that period, of all the <sup>*</sup> debt capital of the entity that gives rise to <sup>*</sup> debt deductions of the entity for that or any other income year, to the extent that the debt capital is not attributable to any of the entity's <sup>*</sup> overseas permanent establishments

**Subdivision 820-E—Thin capitalisation rules for inward investing entities (ADI)**

**Guide to Subdivision 820-E**

**820-390 What this Subdivision is about**

This Subdivision applies to a foreign entity that is an authorised deposit-taking institution (an *ADI*). These rules deal with the following matters:

- how to work out the entity's minimum capital amount for an income year;
- how all or a part of the debt deductions claimed by the entity may be disallowed if the minimum capital amount is not reached;
- how to apply these rules to a period that is less than an income year.

<sup>\*</sup>To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Table of sections****Operative provisions**

820-395	Thin capitalisation rule for inward investing entities (ADI)
820-400	Minimum capital amount
820-405	Safe harbour capital amount
820-410	Arm's length capital amount
820-415	Amount of debt deduction disallowed
820-420	Application to part year periods

**Operative provisions****820-395 Thin capitalisation rule for inward investing entities (ADI)***Thin capitalisation rule*

- (1) This subsection disallows all or a part of each \*debt deduction of an entity for an income year if, for that year:
- (a) the entity is an \*inward investing entity (ADI) (see subsection (2)); and
  - (b) the entity's \*average equity capital (see subsection (3)) is less than its \*minimum capital amount (see section 820-400);
- to the extent that the debt deduction:
- (c) is attributable to an \*Australian permanent establishment of the entity at or through which it carries on its banking business; and
  - (d) is not an \*allowable OB deduction.

Note 1: This Subdivision does not apply if the total debt deductions of that entity and all its associate entities for that year are \$2 million or less, see section 820-35.

Note 2: To work out the amount to be disallowed, see section 820-415.

Note 3: For the rules that apply to an entity that is an inward investing entity (ADI) for part of an income year, see section 820-420 in conjunction with subsection (2) of this section.

Note 4: A consolidated group or MEC group may be an inward investing entity (ADI) to which this Subdivision applies: see Subdivision 820-FB.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-400

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*Inward investing entity (ADI)*

- (2) The entity is an ***inward investing entity (ADI)*** for a period that is all or a part of an income year if, and only if, throughout that period, the entity is a \*foreign bank that carries on its banking business in Australia at or through one or more of its \*Australian permanent establishments.

Note: The entity is required to keep certain records, see Subdivision 820-L.

*Average equity capital*

- (3) The entity's ***average equity capital*** for an income year is the sum of the following:
- (a) the average value, for that year, of the \*ADI equity capital of the entity that:
    - (i) is attributable to the \*Australian permanent establishments at or through which it carries on its banking business in Australia; but
    - (ii) has not been allocated to the \*OB activities of the Australian permanent establishments;
  - (b) the average value, for that year, of the total amounts that:
    - (i) are made available by the entity to the Australian permanent establishments of the entity as loans to the Australian permanent establishments; and
    - (ii) do not give rise to any \*debt deductions of the entity for that or any other income year.

Note: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

**820-400 Minimum capital amount**

The entity's ***minimum capital amount*** for an income year is the lesser of the following amounts:

- (a) the \*safe harbour capital amount;
- (b) the \*arm's length capital amount.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**820-405 Safe harbour capital amount**

The entity's *safe harbour capital amount* for the income year is the result of applying the method statement in this section.

*Method statement*

- Step 1. Work out the average value, for the income year, of that part of the \*risk-weighted assets of the entity that:
- (a) is attributable to the \*Australian permanent establishments at or through which it carries on its banking business in Australia; but
  - (b) is not attributable to the \*OB activities of the Australian permanent establishments.
- Step 2. Multiply the result of step 1 by 6%. The result of this step is the *safe harbour capital amount*.

Example: The Global Bank is a foreign bank that carries on its banking business in Australia through a permanent establishment. The average value of its relevant risk-weighted assets is \$140 million. Multiplying that amount by 6% results in \$8.4 million, which is the safe harbour capital amount.

**820-410 Arm's length capital amount**

- (1) The *arm's length capital amount* is a notional amount that, having regard to:
- (a) the factual assumptions set out in subsection (2); and
  - (b) the relevant factors mentioned in subsection (3);
- would represent the minimum amount of \*equity capital that the entity would reasonably be expected to have in carrying on the Australian business mentioned in subsection (2) throughout the income year if, throughout that year:
- (c) the part of the entity carrying on that business had operated as if it were a separate entity; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-410

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- (d) that separate entity had been dealing at \*arm's length with the other part of the entity.

Note: The entity must keep records in accordance with section 820-980 if the entity works out an amount under this section.

*Factual assumptions*

- (2) Irrespective of what actually happened during that year, the following assumptions must be made in working out that minimum amount:
- (a) the entity's commercial activities in connection with Australia (the **Australian business**) during that year consist only of banking business attributable to its \*Australian permanent establishments (other than its \*OB activities);
  - (b) the entity had carried on the Australian business that it actually carried on during that year;
  - (c) the nature of the entity's assets and liabilities (to the extent that they are attributable to the Australian business) had been as they were during that year;
  - (d) except as mentioned in subsection (1), the entity had carried on the Australian business in the same circumstances as what actually happened during that year.

*Relevant factors*

- (3) On the basis of the factual assumptions set out in subsection (2), the following factors must be taken into account in determining that minimum amount:
- (a) the functions performed, the assets used, and the risks assumed, throughout that year, by:
    - (i) the entity; and
    - (ii) the entity in relation to the Australian business;
  - (b) the credit rating of the entity throughout that year, including the effect of that credit rating on all of the following:
    - (i) the entity's ability to borrow in relation to the Australian business;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) the interest rate at which the entity borrowed in relation to that business;
  - (iii) the entity's gross profit margin in relation to that business;
- (c) the capital ratios of the following throughout that year:
  - (i) the entity;
  - (ii) the entity in relation to the Australian business;
  - (iii) each of the entity's \*associate entities that engage in commercial activities similar to the Australian business;
- (d) the purposes for which \*schemes for \*debt capital and for \*equity capital had been actually entered into, throughout that year, by:
  - (i) the entity; and
  - (ii) the entity in relation to the Australian business;
- (e) the profit (within the meaning of the \*accounting standards or any other accounting standards that would otherwise apply to the entity), and the return on capital, whether during that year or at any other time, of:
  - (i) the entity; and
  - (ii) the entity in relation to the Australian business;
- (f) the commercial practices adopted by independent parties dealing with each other at \*arm's length in the industry in which the entity carries on the Australian business throughout that year (whether in Australia or in comparable markets elsewhere);
- (g) the general state of the Australian economy throughout that year;
- (h) any other factors which are specified in the regulations made for the purposes of this section.

*Commissioner's power*

- (4) If the Commissioner considers an amount worked out by the entity under this section does not appropriately take into account the factual assumptions and the relevant factors, the Commissioner

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 820-415

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may substitute another amount that the Commissioner considers better reflects those assumptions and factors.

### 820-415 Amount of debt deduction disallowed

The amount of \*debt deduction disallowed under subsection 820-395(1) is worked out using the following formula:

$$\text{Debt deduction} \times \frac{\text{Capital shortfall}}{\text{Average debt}}$$

where:

**average debt** means the average value, for the income year, of all the \*debt capital of the entity that gives rise to \*debt deductions of the entity (other than \*allowable OB deductions) for that or any other income year.

**capital shortfall** means the amount by which the entity's \*average equity capital for that year (see subsection 820-395(3)) is less than the entity's \*minimum capital amount for that year.

**debt deduction** means each \*debt deduction of the entity (other than \*allowable OB deduction) for the income year.

Note: The disallowed amount also does not form part of the cost base of a CGT asset. See section 110-54.

### 820-420 Application to part year periods

- (1) This subsection disallows all or a part of each \*debt deduction of an entity for an income year that is an amount incurred by the entity during a period that is a part of that year if, for that period:
- (a) the entity is an \*inward investing entity (ADI); and
  - (b) the entity's \*average equity capital is less than its \*minimum capital amount;
- to the extent that the debt deduction:
- (c) is attributable to an \*Australian permanent establishment of the entity at or through which it carries on its banking business; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

(d) is not an \*allowable OB deduction.

Note: To determine whether an entity is an inward investing entity (ADI) for that period, see subsection 820-395(2).

(2) The entity's **average equity capital** for that period is the sum of the following:

(a) the average value, for that period, of the \*equity capital of the entity that:

- (i) is attributable to its \*Australian permanent establishments at or through which it carries on its banking business in Australia; but
- (ii) has not been allocated to the \*OB activities of the Australian permanent establishments;

(b) the average value, for that period, of the total amounts that:

- (i) are made available by the entity to the Australian permanent establishments of the entity as loans to the Australian permanent establishments; and
- (ii) do not give rise to any \*debt deductions of the entity for that or any other income year.

(3) For the purposes of determining:

- (a) the entity's \*minimum capital amount for that period; and
- (b) the amount of each \*debt deduction to be disallowed;

sections 820-400 to 820-415 apply in relation to that entity and that period with the modifications set out in the following table:

Modifications of sections 820-400 to 820-415		
Item	Provisions	Modifications
1	Sections 820-400 to 820-415	A reference to an income year is taken to be a reference to that period
2	Section 820-415	The reference to subsection 820-395(1) is taken to be a reference to subsection (1) of this section

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 820-430

**Modifications of sections 820-400 to 820-415**

Item	Provisions	Modifications
3	Section 820-415	<p><i>average debt</i> is taken to be the average value, for that period, of all the *debt capital of the entity that gives rise to its *debt deductions (other than *allowable OB deductions) for that year that are amounts incurred by the entity during that period</p> <p><i>average equity capital</i> has the meaning given by subsection (2) of this section</p>

**Subdivision 820-EA—Some financial entities may choose to be treated as ADIs****Table of sections**

820-430	When choice can be made, and what effect it has
820-435	Conditions
820-440	Revocation of choice
820-445	How this Subdivision interacts with Subdivision 820-FA

**820-430 When choice can be made, and what effect it has**

- (1) An entity may choose to be treated, for the purposes of this Division (except this Subdivision), as set out in the table. However, the entity can make the choice only if subsection (5) is satisfied.

**Choice by financial entity to be treated as an ADI**

	Column 1	Column 2
Item	For a period that the choice covers, and for which the entity would, apart from this Subdivision, have been:	The entity is treated as if it had instead been:
1	an *outward investor (financial)	an *outward investing entity (ADI)
2	an *inward investor (financial)	an *inward investing entity (ADI)

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Choice by financial entity to be treated as an ADI**

	<b>Column 1</b>	<b>Column 2</b>
<b>Item</b>	<b>For a period that the choice covers, and for which the entity would, apart from this Subdivision, have been:</b>	<b>The entity is treated as if it had instead been:</b>
3	an *inward investment vehicle (financial)	an *outward investing entity (ADI)

- (2) The choice:
- (a) has effect accordingly, except as provided in subsection (4); and
  - (b) ceases to have effect only as provided in this Subdivision; and
  - (c) covers each period:
    - (i) that started on or after a day specified in the choice (or on the day the choice is made if no day is specified); and
    - (ii) that is all or part of an income year.
- (3) Subdivision 820-E applies to the entity, in relation to a period for which this section treats it as an \*inward investing entity (ADI), as if all the entity's \*business were banking business of the entity.
- (4) The choice does not have effect for the purposes of determining whether the entity is covered by paragraph 820-910(2)(a) (about working out the associate entity debt of another entity).

*Conditions for making the choice*

- (5) For the income year that is or includes the first period for which the entity would be treated in accordance with the choice, the entity must satisfy:
- (a) subsection 820-435(1); or
  - (b) subsections 820-435(2) and (3).
- Also, the entity must *not* have made a previous choice under this section that has ceased to have effect.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 820-435**

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*Conditions are retested every 3 years*

- (6) The choice ceases to have effect, or is taken to have ceased to have effect, as appropriate, at the *end* of an income year covered by subsection (7) of this section, unless the entity:
  - (a) satisfies subsection 820-435(1) for that income year; or
  - (b) satisfies subsections 820-435(2) and (3) for that income year.
- (7) This subsection covers every third income year after the one referred to in subsection (5).

**820-435 Conditions**

- (1) An entity satisfies this subsection for an income year if the average value, for that income year, of the entity's \*on-lent amount is at least 80% of the average value, for that income year, of all the entity's assets.
- (2) An entity satisfies this subsection for an income year if the first period that is all or part of that income year, and for which the entity would be treated in accordance with a choice under section 820-430, consists of one or more periods, each of which is either or both of these:
  - (a) a period throughout which the entity is a \*financial entity because of paragraph (d) of the definition of ***financial entity*** in subsection 995-1(1) (which covers licensed (or exempt) dealers in derivatives);
  - (b) a period throughout which:
    - (i) the entity is the \*head company of a \*consolidated group or \*MEC group; and
    - (ii) at least one \*member of the group is a financial entity because of that paragraph.
- (3) An entity satisfies this subsection for an income year if it satisfies subsection (2) and the amount worked out using this formula is greater than or equal to 0.8:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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$$\frac{\text{On-lent amount} + \left( \text{UG on derivatives} - \text{UL on derivatives} \right)}{\text{Total assets} - \text{UL on derivatives}}$$

where:

**on-lent amount** means the average value, for that income year, of the entity's \*on-lent amount.

**total assets** means the average value, for that income year, of all the entity's assets.

**UG on derivatives** means the average value, for that income year, of the entity's assets consisting of unrealised gains on trading derivatives within the meaning of the *Corporations Act 2001*.

**UL on derivatives** means the lesser of:

- (a) the average value, for that income year, of the entity's liabilities consisting of unrealised losses on trading derivatives within the meaning of the *Corporations Act 2001*; and
- (b) the average value, for that income year, of the entity's assets consisting of unrealised gains on trading derivatives within the meaning of that Act.

*On-lent amount increased for financial entity whose assets include precious metals*

- (4) In working out whether an entity satisfies subsection (1) or (3) for an income year, the average value, for that income year, of the entity's \*on-lent amount is increased by the average value, for that income year, of the entity's assets that consist of \*precious metals, but only if the entity satisfies subsection (5) for that income year.
- (5) An entity satisfies this subsection for an income year if the first period that is all or part of that income year, and for which the entity would be treated in accordance with a choice under

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 820-440**

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section 820-430, consists of one or more periods, each of which is either or both of these:

- (a) a period throughout which the entity is a \*financial entity;
- (b) a period throughout which:
  - (i) the entity is the \*head company of a \*consolidated group or \*MEC group; and
  - (ii) at least one \*member of the group is a financial entity.

**820-440 Revocation of choice**

- (1) A choice under section 820-430 can be revoked only with the written approval of the Commissioner. The Commissioner may approve a revocation only if satisfied that the entity's circumstances have changed significantly since the choice was made.
- (2) If revoked, the choice does not have effect for a period that starts on or after the day on which the Commissioner's approval is given, unless the revocation is expressed to take effect on an earlier day. In that case, it does not have effect for a period that starts on or after the earlier day.

**820-445 How this Subdivision interacts with Subdivision 820-FA**

A choice under section 820-430 does not have effect for so much of a period as happens while the entity is a \*subsidiary member of a \*consolidated group or \*MEC group.

**Note:** If the head company of the group makes a choice under that section, that choice will have effect instead.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Subdivision 820-FA—How the thin capitalisation rules apply to consolidated groups and MEC groups**

### **Guide to Subdivision 820-FA**

#### **820-579 What this Subdivision is about**

This Subdivision tells you:

- how to classify the head company of a consolidated group or MEC group (in terms of which Subdivision of this Division to apply to the head company); and
- how to apply this Division to the head company (including how the application is modified).

#### **Table of sections**

##### **Operative provisions**

820-581	How this Division applies to head company for income year in which group comes into existence or ceases to exist
820-583	Classification of head company
820-584	Exempt special purpose entities treated as not being member of group
820-585	Exemption for consolidated group headed by foreign-controlled Australian ADI or its holding company
820-587	Additional application of Subdivision 820-D to MEC group that includes foreign-controlled Australian ADI
820-588	Choice to treat specialist credit card institutions as being financial entities and not ADIs
820-589	How Subdivision 820-D applies to a MEC group

#### **Operative provisions**

##### **820-581 How this Division applies to head company for income year in which group comes into existence or ceases to exist**

If a \*consolidated group or \*MEC group:

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 820-583

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- (a) comes into existence at a time during an income year that is not the start of the income year; or
- (b) ceases to exist at a time during an income year that is not the end of the income year;

then, for each of the following periods during that income year:

- (c) a period throughout which a company is the \*head company of that group; or
- (d) a period throughout which that company is the head company of a different consolidated group or MEC group; or
- (e) a period throughout which that company is a \*member of no consolidated group or MEC group;

this Division (except this section) is to have either:

- (f) a single application in relation to the whole of the period; or
- (g) 2 or more applications, each in relation to a part of that period.

Example: Austco Ltd is not a member of a consolidated group for the first 6 months of an income year, but then becomes the head company of a consolidated group which continues in existence for the rest of the income year.

For those first 6 months Austco is an outward investor (general) under section 820-85. For the rest of the income year Austco is an outward investor (general) under subsection 820-583(2).

This section ensures that section 820-120 (about part year periods) applies to Austco instead of section 820-85, so that Subdivision 820-B has 2 separate applications to Austco: one for the first 6 months and the other for the rest of the income year. Under the second application, account is taken of the position of the subsidiary members that are taken to be part of Austco as head company of the consolidated group.

### 820-583 Classification of head company

#### *Outward investing entity (non-ADI)*

- (1) The \*head company of a \*consolidated group or of a \*MEC group is an ***outward investing entity (non-ADI)*** for a period that is all or part of an income year if, and only if, it is:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (a) an \*outward investor (general) for that period (because of subsection (2)); or
- (b) an \*outward investor (financial) for that period (because of subsection (3)).

*Outward investor (general)*

- (2) The \*head company of a \*consolidated group or of a \*MEC group is an **outward investor (general)** for a period that is all or part of an income year if:
  - (a) for that period, the head company satisfies the condition in the second column of item 1 or 3 of the table in subsection 820-85(2); and
  - (b) no \*member of the group is a \*financial entity or \*ADI at any time during that period.

*Outward investor (financial)*

- (3) The \*head company of a \*consolidated group or of a \*MEC group is an **outward investor (financial)** for a period that is all or part of an income year if:
  - (a) for that period, the head company satisfies the condition in the second column of item 1 or 3 of the table in subsection 820-85(2); and
  - (b) throughout that period, there is at least one \*member of the group that is a \*financial entity; and
  - (c) no \*member of the group is an \*ADI at any time during that period.

*Inward investing entity (non-ADI)*

- (4) The \*head company of a \*consolidated group or of a \*MEC group is an **inward investing entity (non-ADI)** for a period that is all or part of an income year if, and only if, it is:
  - (a) an \*inward investment vehicle (general) for that period (because of subsection (5)); or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-583

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- (b) an \*inward investment vehicle (financial) for that period (because of subsection (6)).

*Inward investment vehicle (general)*

- (5) The \*head company of a \*consolidated group or of a \*MEC group is an ***inward investment vehicle (general)*** for a period that is all or part of an income year if:
  - (a) throughout that period, the head company is a \*foreign controlled Australian entity; and
  - (b) no member of the group is a \*financial entity or \*ADI at any time during that period.

*Inward investment vehicle (financial)*

- (6) The \*head company of a \*consolidated group or of a \*MEC group is an ***inward investment vehicle (financial)*** for a period that is all or part of an income year if:
  - (a) throughout that period, the head company is a \*foreign controlled Australian entity; and
  - (b) throughout that period, there is at least one \*member of the group that is a \*financial entity; and
  - (c) no member of the group is an \*ADI at any time during that period.

*Outward investing entity (ADI)*

- (7) The \*head company of a \*consolidated group or of a \*MEC group is an ***outward investing entity (ADI)*** for a period that is all or part of an income year if, and only if:
  - (a) apart from Part 3-90 (about consolidation of groups) and this Subdivision, at least one \*member of the group would be an \*outward investing entity (ADI) for that period; or
  - (b) these conditions are met:
    - (i) at least one member of the group would, apart from that Part and this Subdivision, be an \*outward investing entity (non-ADI) for that period; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) at least one member of the group is an \*ADI throughout that period.

**820-584 Exempt special purpose entities treated as not being member of group**

While an entity meets the conditions in subsection 820-39(3) (about insolvency-remote special purpose entities established to manage economic risk), the entity is treated for the purposes of this Division (except this section) as *not* being a \*member of a \*consolidated group or \*MEC group of which it is a member.

Note: This section has the effect that the circumstances of the entity are not taken into account in applying this Division to the head company of the group. The entity itself is exempt from this Division because of section 820-39.

**820-585 Exemption for consolidated group headed by foreign-controlled Australian ADI or its holding company**

- (1) This Division does not disallow any of a \*debt deduction for an income year if:
- (a) the debt deduction is of the \*head company of a \*consolidated group and the head company satisfies subsection (2) for that income year; or
  - (b) the debt deduction is an amount incurred by the head company of a consolidated group during a period that is part of that income year, and the head company satisfies subsection (2) for that period.
- (2) The \*head company satisfies this subsection for a period that is all or part of an income year if, throughout that period:
- (a) the head company is both a \*foreign controlled Australian company and an \*ADI (and would also be an ADI apart from Part 3-90 (about consolidation of groups)); or
  - (b) the head company:
    - (i) is a \*foreign controlled Australian company; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-587

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- (ii) beneficially owns all the \*membership interests in a \*member of the group that is both a \*foreign controlled Australian entity and an \*ADI throughout that period; and
  - (iii) would, apart from Part 3-90 (about consolidation of groups), have no other assets and no \*debt capital; unless at least one member of the group would, apart from that Part and this Subdivision, be an \*outward investing entity (non-ADI) or \*outward investing entity (ADI) for all or part of that period.
- (3) Subsection (1) does not apply if, at each time in the period mentioned in subsection (2), all the \*ADIs that are \*members of the group then are \*specialist credit card institutions.

**820-587 Additional application of Subdivision 820-D to MEC group that includes foreign-controlled Australian ADI**

Subdivision 820-D applies to the \*head company of a \*MEC group as if it were an \*outward investing entity (ADI) for a period that is all or part of an income year if:

- (a) the head company is *not* an outward investing entity (ADI) for that period; and
- (b) throughout that period, at least one \*member of the group is both a \*foreign controlled Australian entity and an \*ADI; and
- (c) throughout that period, there is at least one \*eligible tier-1 company of the \*top company for the group that:
  - (i) is a member of the group; and
  - (ii) is *not* an ADI; and
  - (iii) has no \*wholly-owned subsidiary that is an ADI.

**820-588 Choice to treat specialist credit card institutions as being financial entities and not ADIs**

- (1) If the conditions in subsection (2) are met in relation to a \*consolidated group or \*MEC group and a period that is all or part

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

of an income year, this Division (except this section) has effect as if:

- (a) none of the \*members of the group were an \*ADI at any time in the period; and
- (b) each member of the group that is an ADI (ignoring paragraph (a)) at any time in the period were a financial entity at that time.

Note 1: One result of this Division having effect in that way is that Subdivision 820-D (and related provisions, such as section 820-589) will not apply in relation to the head company, because:

- (a) the head company of the group will not be classified under section 820-583 as an outward investing entity (ADI); and
- (b) section 820-587 will not apply that Subdivision.

Note 2: Another result of this Division having effect in that way is that Subdivision 820-B or 820-C may apply in relation to the head company, because it may be classified under section 820-583 as either:

- (a) an outward investing entity (non-ADI) and an outward investor (financial); or
- (b) an inward investing entity (non-ADI) and an inward investment vehicle (financial).

(2) The conditions are that:

- (a) at all times in the period at least one \*member of the \*consolidated group or \*MEC group is an \*ADI; and
- (b) each ADI that is a member of the group at any time in the period is a \*specialist credit card institution at that time; and
- (c) the \*head company of the group for the period chooses, before lodging its \*income tax return for the income year, that this Division should have effect in that way in relation to the group and every period for which the conditions in paragraphs (a) and (b) are met in the income year.

(3) An \*ADI is a ***specialist credit card institution*** at a time if, at that time, the ADI's authority under section 9 of the *Banking Act 1959* to carry on banking business (as defined in that Act) authorises the ADI to carry on only banking business that:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) is participation in a payment system (as defined in the *Payment Systems (Regulation) Act 1998*) that is a credit card scheme and is designated under section 11 of that Act; and
- (b) is either or both of the following:
  - (i) credit card acquiring (as defined in regulations made for the purposes of the *Banking Act 1959*);
  - (ii) credit card issuing (as defined in those regulations).
- (4) To avoid doubt, a choice for the purposes of paragraph (2)(c) cannot be revoked.

**820-589 How Subdivision 820-D applies to a MEC group**

- (1) This section has effect for the purposes of working out the \*adjusted average equity capital of the \*head company of a \*MEC group for a period (the *test period*) that is all or part of an income year if Subdivision 820-D applies to the head company in relation to that period.

Note: Section 820-587 extends the application of Subdivision 820-D.

- (2) The \*head company's \*ADI equity capital at a particular time during the test period is to be worked out:
  - (a) taking into account an \*equity interest or \*debt interest in the head company only if it is held at that time by an entity that is *not* a member of the group; and
  - (b) on the basis that an equity interest or debt interest in an \*eligible tier-1 company (other than the head company) that is a member of the group at that time is treated as an equity interest or debt interest (as appropriate) in the head company, but only if it is held at that time by an entity that is *not* a member of the group; and
  - (c) on the basis of the information that would be contained in a set of consolidated accounts:
    - (i) prepared, in accordance with the \*accounting standard on consolidated accounts, as at that time; and
    - (ii) covering the members of the group as at that time.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



## **Subdivision 820-FB—Grouping branches of foreign banks and foreign financial entities with a consolidated group, MEC group or single Australian resident company**

### **Guide to Subdivision 820-FB**

#### **820-595 What this Subdivision is about**

If:

- (a) the head company of a consolidated group or MEC group; or
- (b) an Australian company that cannot consolidate;

is a member of the same wholly-owned group as a foreign bank or foreign financial entity, the company can choose to treat as part of itself the Australian branches of the foreign bank or foreign financial entity, affecting how the rest of this Division applies.

#### **Table of sections**

##### **Choice to group with branches of foreign banks and foreign financial entities**

- 820-597 Choice by head company of consolidated group or MEC group
- 820-599 Choice by Australian resident company outside consolidatable group and MEC group

##### **Effect of choice**

- 820-601 Application
- 820-603 General
- 820-605 Effect on establishment entity if certain debt deductions disallowed
- 820-607 Effect on test periods under this Division
- 820-609 Effect on classification of head company or single company
- 820-610 Choice not to be outward investing entity (ADI) or inward investing entity (ADI)

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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820-611 Values to be based on what would be in consolidated accounts for group

820-613 How Subdivision 820-D applies

820-615 How Subdivision 820-E applies

## Choice to group with branches of foreign banks and foreign financial entities

### 820-597 Choice by head company of consolidated group or MEC group

- (1) This section applies if there is a period (the *grouping period*) for which all these conditions are met:
- (a) the period was all or part of an income year of the \*head company of a \*consolidated group or \*MEC group;
  - (b) the consolidated group or MEC group existed throughout the period;
  - (c) the head company and an entity (the *establishment entity*) covered by one of the following subparagraphs are both members of the same \*wholly-owned group throughout the period:
    - (i) a \*foreign bank that carried on its banking \*business in Australia through at least one \*Australian permanent establishment at each time in the period;
    - (ii) a \*foreign entity that was a \*financial entity and had at least one Australian permanent establishment at each time in the period;
  - (d) there is not a longer period in the income year for which the conditions in paragraphs (a), (b) and (c) are met in relation to the head company and the establishment entity.
- Note: It does not matter whether the income year ended on the same day for the head company and the establishment entity.
- (2) The \*head company may choose to have all of the \*Australian permanent establishments of the establishment entity treated as part of the head company for the grouping period for the purposes of this Division.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (3) If the conditions in subsection (1) are met in relation to the \*head company and more than one other establishment entity, the head company may make a different choice in relation to each of the other establishment entities.

**820-599 Choice by Australian resident company outside consolidatable group and MEC group**

- (1) This section applies if there is a period (also the *grouping period*) for which all these conditions are met:
- (a) the period was all or part of an income year of a company (the *single company*);
  - (b) throughout the period the single company:
    - (i) was an \*Australian entity; and
    - (ii) was not a \*prescribed dual resident; and
    - (iii) was not a \*member of a \*consolidatable group; and
    - (iv) was not a member of a \*consolidated group; and
    - (v) was not a member of a \*MEC group;
  - (c) the single company and an entity (the *establishment entity*) covered by one of the following subparagraphs are both members of the same \*wholly-owned group throughout the period:
    - (i) a \*foreign bank that carried on its banking \*business in Australia through at least one \*Australian permanent establishment at each time in the period;
    - (ii) a \*foreign entity that was a \*financial entity and had at least one Australian permanent establishment at each time in the period;
  - (d) there is not a longer period in the income year for which the conditions in paragraphs (a), (b) and (c) are met in relation to the single company and the establishment entity.

Note: It does not matter whether the income year ended on the same day for the single company and the establishment entity.

- (2) The single company may choose to have all of the \*Australian permanent establishments of the establishment entity treated as part

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 820-601**

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of the single company for the grouping period for the purposes of this Division.

- (3) If the conditions in subsection (1) are met in relation to the single company and more than one other establishment entity, the single company may make a different choice in relation to each of the other establishment entities.

**Effect of choice**

**820-601 Application**

Sections 820-603 to 820-615 apply if a choice is made under section 820-597 or 820-599.

**820-603 General**

- (1) The choice cannot be revoked in relation to the grouping period. It binds the \*head company or the single company, as appropriate, and the establishment entity.
- (2) The rest of this section applies:
- (a) to each \*Australian permanent establishment that:
    - (i) was an Australian permanent establishment of the establishment entity; and
    - (ii) if the establishment entity was a \*foreign bank—was an Australian permanent establishment through which the entity carried on banking \*business in Australia at any time in the grouping period; and
  - (b) in relation to each time (the **test time**) that was in the grouping period and was when the Australian permanent establishment:
    - (i) was an Australian permanent establishment of the establishment entity; and
    - (ii) if the establishment entity was a foreign bank—was an Australian permanent establishment through which the entity carried on banking business in Australia.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (3) In the case of a choice under section 820-597, this Division (except Subdivision 820-FA, this Subdivision and Subdivision 820-L) applies as if, at the test time, the \*Australian permanent establishment:
- (a) had been part of the \*head company; and
  - (b) had *not* been part of the establishment entity; and
  - (c) were a \*subsidiary member of the \*consolidated group or \*MEC group.
- (4) In the case of a choice under section 820-599, this Division (except Subdivision 820-FA, this Subdivision and Subdivision 820-L) applies as if, at the test time:
- (a) the \*Australian permanent establishment had been part of the single company and had *not* been part of the establishment entity; and
  - (b) the single company were a \*consolidated group of which the single company was the \*head company and the Australian permanent establishment was a \*subsidiary member.
- (5) In either case, without limiting subsection (3) or (4), this Division (except Subdivision 820-FA, this Subdivision and Subdivision 820-L) applies as if:
- (a) the \*Australian permanent establishment were an entity at that time; and
  - (b) each asset and liability of the establishment entity at the test time that is attributable to the Australian permanent establishment were an asset or liability of the Australian permanent establishment at that time; and
  - (c) without limiting paragraph (b) of this subsection, each cost that:
    - (i) is a \*debt deduction of the establishment entity incurred at the test time; and
    - (ii) is attributable to the Australian permanent establishment;were a cost incurred by the Australian permanent establishment at that time;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 820-605**

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For the effects of disallowing debt deductions, see section 820-605.

- (6) However, the application of this Division because of this section is subject to the modifications set out in sections 820-607 to 820-615.
- (7) For the purposes of this Division (as applying because of this Subdivision), this Act (except this Division) applies as if the matters referred to in subsections (3), (4) and (5) of this section were the case.

**Note:** For example, this means that a head company is treated for the purposes of this Division as if it had debt deductions based on the actual costs incurred by an Australian permanent establishment while it is treated as part of the head company because of this section.

**820-605 Effect on establishment entity if certain debt deductions disallowed**

If:

- (a) apart from this Division, a \*debt deduction would be a deduction of the establishment entity for an income year; and
- (b) this Division (as applying because of this Subdivision) disallows all or part of the deduction (treated as a deduction of the \*head company or single company);

this section disallows the deduction of the establishment entity, or that part of it, as appropriate.

**Note 1A:** The disallowed amount also does not form part of the cost base of a CGT asset. See section 110-54.

**Note 1:** This Division does not disallow a debt deduction that the establishment entity incurs during the grouping period and that consists of a cost that is:

- attributable to an Australian permanent establishment covered by the choice under section 820-597 or 820-599; and
- paid or owed to the head company or single company.

The cost is not a debt deduction of the head company or single company for the purposes of this Division as applying because of this Subdivision. This is because subsection 820-603(3) or (4) treats the Australian permanent establishment as being part of the head company or single company, so the cost is treated as being paid or owed by the head company or single company to itself.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 820-607**

Because subsection 820-603(3) or (4) also treats the Australian permanent establishment as not being part of the establishment entity, the cost is not a debt deduction of the establishment entity, so it is not disallowed by this Division as applying to the establishment entity.

- Note 2: This Division also does not disallow a debt deduction that the head company or single company incurs during the grouping period and that consists of a cost that is:
- paid or owed to the establishment entity; and
  - is attributable to an Australian permanent establishment covered by the choice under section 820-597 or 820-599.

The cost is not a debt deduction of the head company or single company for the purposes of this Division as applying because of this Subdivision. This is because subsection 820-603(3) or (4) treats the Australian permanent establishment as being part of the head company or single company, so the cost is treated as being paid or owed by the head company or single company to itself.

**820-607 Effect on test periods under this Division**

If, apart from this section, this Division (except this Subdivision) would have a single application to the \*head company or single company, or to the establishment entity, in relation to a period (the *test period*) that:

- (a) is all or part of an income year of that entity; and
- (b) overlaps the grouping period;

this Division (except this section) is to have separate applications to that entity as follows:

- (c) a single application in relation to the period of overlap; and
- (d) a single application in relation to the part (if any) of the test period that is before the period of overlap; and
- (e) a single application in relation to the part (if any) of the test period that is after the period of overlap.

**820-609 Effect on classification of head company or single company**

- (1) The \*head company or single company is an *outward investing entity (ADI)* for a period (the *trial period*) that is all or part of the grouping period if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-609

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- (a) apart from this Subdivision, the head company or single company would be an *\*outward investing entity (ADI)* for the trial period; or
  - (b) apart from this Subdivision, the head company or single company would be:
    - (i) an *\*outward investing entity (non-ADI)* and an *\*outward investor (financial)* for the trial period; or
    - (ii) an *\*outward investing entity (non-ADI)* and an *\*outward investor (general)* for the trial period;and at least one of the *\*Australian permanent establishments* is a *\*permanent establishment* through which a *\*foreign bank* carries on banking *\*business* in Australia.
- (2) The *\*head company* is also an ***outward investing entity (ADI)*** for the trial period if, apart from this Subdivision:
- (a) section 820-585 would prevent the disallowance of a *\*debt deduction* for the income year including the trial period; or
  - (b) section 820-587 would apply Subdivision 820-D to the head company as if it were an *\*outward investing entity (ADI)* for the trial period.
- (3) The single company is also an ***outward investing entity (ADI)*** for the trial period if it is both a *\*foreign controlled Australian company* and an *\*ADI* for that period.
- (4) The *\*head company* or single company is an ***inward investing entity (ADI)*** for the trial period if:
- (a) apart from this Subdivision, it would be an *\*inward investment vehicle (general)* or an *\*inward investment vehicle (financial)*, and not an *\*outward investor (general)* or an *\*outward investor (financial)*, for the trial period; and
  - (b) at least one of the *\*Australian permanent establishments* is a *\*permanent establishment* through which a *\*foreign bank* carries on banking *\*business* in Australia.
- (5) The *\*head company* or single company is an ***outward investing entity (non-ADI)*** and an ***outward investor (financial)*** for the trial

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*\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.*

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period if, apart from this Subdivision, it would be an \*outward investing entity (non-ADI) and:

- (a) an \*outward investor (financial); or
- (b) an \*outward investor (general);

for that period, and:

- (c) at least one of the \*Australian permanent establishments is a \*permanent establishment of a \*foreign entity that is a \*financial entity; and
  - (d) none of the Australian permanent establishments is a permanent establishment through which a \*foreign bank carries on banking \*business in Australia.
- (6) The \*head company or single company is an ***inward investing entity (non-ADI)*** and an ***inward investment vehicle (financial)*** for the trial period if, apart from this Subdivision, it would be an \*inward investing entity (non-ADI) and:
- (a) an \*inward investment vehicle (financial); or
  - (b) an \*inward investment vehicle (general);
- for that period and not an \*outward investor (general) or an \*outward investor (financial) for that period and:
- (c) at least one of the \*Australian permanent establishments is a \*permanent establishment of a \*foreign entity that is a \*financial entity; and
  - (d) none of the Australian permanent establishments is a permanent establishment through which a \*foreign bank carries on banking \*business in Australia.
- (7) This section has effect despite any other provision of this Division, except Subdivision 820-EA and section 820-610.

**Note:** If the head company or single company is an outward investor (financial) or inward investment vehicle (financial) under this section and satisfies subsection 820-430(5), it may choose under Subdivision 820-EA to be treated as an outward investing entity (ADI). Section 820-603 affects whether the company satisfies that subsection, by treating as part of the company each relevant foreign financial entity's Australian permanent establishment.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-610

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**820-610 Choice not to be outward investing entity (ADI) or inward investing entity (ADI)**

- (1) This section applies if:
  - (a) apart from this section, the \*head company or single company would, under section 820-609, be an \*outward investing entity (ADI) or an \*inward investing entity (ADI) for the trial period; and
  - (b) at all times in the trial period, each of the following entities that is an \*ADI is a \*specialist credit card institution:
    - (i) the head company or single company;
    - (ii) an establishment entity whose \*Australian permanent establishments the head company or single company has chosen under section 820-597 or 820-599 to have treated as part of the company for the period.
- (2) The \*head company or single company is an **outward investing entity (non-ADI)** and an **outward investor (financial)** for the trial period if:
  - (a) apart from this section, the company would, under section 820-609, be an \*outward investing entity (ADI) for the trial period; and
  - (b) the company chooses, before lodging its \*income tax return for the income year including the trial period, to be an outward investing entity (non-ADI) and an outward investor (financial) for that period.
- (3) The \*head company or single company is an **inward investing entity (non-ADI)** and an **inward investment vehicle (financial)** for the trial period if:
  - (a) apart from this section, the company would, under section 820-609, be an \*inward investing entity (ADI) for the trial period; and
  - (b) the company chooses, before lodging its \*income tax return for the income year including the trial period, to be an inward investing entity (non-ADI) and an inward investment vehicle (financial) for that period.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (4) This section has effect despite sections 820-85, 820-185 and 820-609.

### **820-611 Values to be based on what would be in consolidated accounts for group**

- (1) For the purposes of this Division as applying because of this Subdivision, the value or amount of a particular matter as at a particular time during the grouping period is to be worked out, so far as practicable, on the basis of the information that would be contained in a set of consolidated accounts:
- (a) prepared, in accordance with the \*accounting standard on consolidated accounts, as at that time; and
  - (b) covering the \*consolidated group, \*MEC group or single company, as appropriate, and each \*Australian permanent establishment that section 820-603 treats as part of the \*head company or single company at that time.

Note: This subsection does not depend on whether such a set of consolidated accounts was prepared, or had to be prepared, for other purposes.

- (2) To avoid doubt, subsection (1) also applies to working out the value or amount, as at a particular time, of a matter mentioned in any of sections 820-613 to 820-615.

### **820-613 How Subdivision 820-D applies**

- (1) This section has effect for the purposes of applying Subdivision 820-D to the \*head company or single company in relation to a period (the *test period*) that is all or part of the grouping period.

Note: Subdivision 820-D applies to the head company or single company if it is classified as an outward investing entity (ADI) because of section 820-609, either alone or in conjunction with a choice made by the company under section 820-430.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 820-613**

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*Adjusted average equity capital*

- (2) The \*adjusted average equity capital of the \*head company or single company for the test period is increased by the average value, for the period, of the amount worked out under subsection (3).

Note 1: In the case of a choice under section 820-599, paragraph 820-603(4)(b) treats the single company and the relevant Australian permanent establishments as a consolidated group.

Note 2: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

- (3) The amount worked out under this subsection as at a particular day is the total of the amounts worked out under the following paragraphs for each of the establishment entity's \*Australian permanent establishments that section 820-603 treats as part of the \*head company or single company on that day:

(a) so much of the establishment entity's \*ADI equity capital, at the end of the day, as:

(i) is attributable to that Australian permanent establishment; and

(ii) has not been allocated to the \*OB activities of the entity;

(b) the amounts that, as at the end of that day:

(i) are made available by the establishment entity to the Australian permanent establishment as loans to it; and

(ii) do not give rise to any \*debt deductions of the entity for the income year or any other income year.

Note: The amounts are to be worked out, so far as practicable, on the basis of the information that would be contained in a set of consolidated accounts. See section 820-611.

*Risk-weighted assets*

- (4) For each of the establishment entity's \*Australian permanent establishments that is covered by the choice, the \*risk-weighted assets of the \*head company or single company include that part of the entity's risk-weighted assets that:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (a) is attributable to that Australian permanent establishment;  
and
- (b) is not attributable to the entity's \*OB activities.

**820-615 How Subdivision 820-E applies**

- (1) This section has effect for the purposes of applying Subdivision 820-E to the \*head company or single company in relation to a period (the **test period**) that is all or part of the grouping period.

Note: Subdivision 820-E applies to the head company or single company if it is classified as an inward investing entity (ADI) because of section 820-609.

*Average equity capital*

- (2) The **average equity capital** of the \*head company or single company for the test period is:
  - (a) the average value, for that period, of all the \*ADI equity capital of the company; plus
  - (b) the average value, for that period, of the amount worked out under subsection 820-613(3).

Note 1: In the case of a choice under section 820-599, paragraph 820-603(4)(b) treats the single company and the relevant Australian permanent establishments as a consolidated group.

Note 2: To calculate an average value for the purposes of this Division, see Subdivision 820-G.

*Safe harbour capital amount*

- (3) The **safe harbour capital amount** of the \*head company or single company for the test period is worked out using the following method statement.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-625

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*Method statement*

- Step 1. Work out the average value, for the test period, of the \*head company's or single company's \*risk-weighted assets.
- Step 2. Multiply the result of step 1 by 6%. The result of this step is the *safe harbour capital amount*.

*Risk-weighted assets*

- (4) For each of the establishment entity's \*Australian permanent establishments covered by the choice, the \*risk-weighted assets of the \*head company or single company include that part of the entity's risk-weighted assets that:
- (a) is attributable to that Australian permanent establishment; and
  - (b) is not attributable to the entity's \*OB activities.

**Subdivision 820-G—Calculating the average values**

**Guide to Subdivision 820-G**

**820-625 What this Subdivision is about**

This Subdivision sets out the methods of calculating the average values for the purposes of this Division. It also includes special rules about values and valuation that are relevant to that calculation.

Note: Section 820-25 of the *Income Tax (Transitional Provisions) Act 1997* provides for a transitional rule that affects the operation of this Subdivision in relation to an income year that begins before 1 July 2002 and ends before 30 June 2003.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Table of sections****How to calculate the average values**

- 820-630 Methods of calculating average values
- 820-635 The opening and closing balances method
- 820-640 The 3 measurement days method
- 820-645 The frequent measurement method

**Special rules about values and valuation**

- 820-675 Amount to be expressed in Australian currency
- 820-680 Valuation of assets, liabilities and equity capital
- 820-682 Recognition of assets and liabilities—modifying application of accounting standards
- 820-685 Valuation of debt capital
- 820-690 Commissioner's power

**How to calculate the average values****820-630 Methods of calculating average values***Methods of calculation for entities that are not ADIs*

- (1) An entity to which Subdivision 820-B or 820-C applies for a period that is all or a part of an income year must use one of the following methods to calculate the average value of a matter mentioned in that Subdivision for the purposes of that application:
  - (a) the method set out in section 820-635 (the ***opening and closing balances method***);
  - (b) the method set out in section 820-640 (the ***3 measurement days method***);
  - (c) the method set out in section 820-645 (the ***frequent measurement method***).

Note 1: This subsection therefore applies only to an outward investing entity (non-ADI) or an inward investing entity (non-ADI).

Note 2: An entity cannot apply the 3 measurement days method if it is unable to meet the requirements in subsection 820-640(1). An entity's ability to apply that method may therefore be limited.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 820-635**

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- (2) The entity must use the same method to calculate all such average values for that period for the purposes of that application.

*Commissioner's power*

- (3) If the entity fails to comply with subsection (2), the Commissioner may, irrespective of the methods used by the entity, recalculate all the average values for the entity and that period by using the opening and closing balances method.

*Method of calculation for ADIs*

- (4) An entity to which Subdivision 820-D or 820-E applies for a period that is all or a part of an income year must use the frequent measurement method to calculate the average value of a matter mentioned in that Subdivision for the purposes of that application.

Note: This subsection therefore applies only to an outward investing entity (ADI) or an inward investing entity (ADI).

**820-635 The opening and closing balances method**

An entity that uses the opening and closing balances method for a period must apply the following method statement to calculate the average value of a matter for that period.

*Method statement*

- Step 1. Work out the value of the particular matter as at the first day of that period.
- Step 2. Work out the value of the particular matter as at the last day of that period.
- Step 3. Add the results of steps 1 and 2.
- Step 4. Divide the result of step 3 by 2. The result of this step is the average value.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



Example: ALWZ Corporation, a company that is an Australian entity, held assets valued at \$95 million on the first day of an income year. It held assets valued at \$105 million at the end of that year. Adding those amounts and dividing the result by 2 gives the average value of its assets for that year, which is \$100 million.

### **820-640 The 3 measurement days method**

#### *Application*

- (1) An entity must not use the 3 measurement days method for a period that is a part of an income year unless the following days occur during that period:
  - (a) the last day of the first half of the income year;
  - (b) one or both of the following days:
    - (i) the first day of that year;
    - (ii) the last day of that year.

#### *Method statement*

- (2) An entity that uses the 3 measurement days method for a period must apply the following method statement to calculate the average value of a matter for that period.

#### *Method statement*

- Step 1. Work out the value of the particular matter as at the first measurement day (see subsection (3)).
- Step 2. Work out the value of the particular matter as at the second measurement day (see subsection (3)).
- Step 3. Work out the value of the particular matter as at the third measurement day (see subsection (3)).
- Step 4. Add the results of steps 1, 2 and 3.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-645

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Step 5. Divide the result of step 4 by 3. The result of this step is the average value.

Example: RJ Corporation held assets valued at \$115 million on the first day of an income year. It held assets valued at \$105 million on the last day of the first half of that year, and \$80 million on the last day of that year. Adding these amounts and dividing the result by 3 gives the average value of its assets for that year, which is \$100 million.

*Measurement days*

- (3) The following are the **first**, **second** and **third measurement days**:
- (a) the **first measurement day** is the first day of the income year if it occurs during that period, otherwise it is the first day of that period;
  - (b) the **second measurement day** is the last day of the first half of that year;
  - (c) the **third measurement day** is the last day of that year if it occurs during that period, otherwise it is the last day of that period.

**820-645 The frequent measurement method**

- (1) An entity that uses the frequent measurement method for a period (the **measurement period**) must calculate the average value of a matter for that period by applying:
- (a) the method statement in subsection (2) (generally based on quarterly periods); or
  - (b) the method statement in subsection (4) (generally based on regular intervals).

This section does not prevent the entity from applying the method statement in subsection (2) for one matter and the method statement in subsection (4) for another matter in relation to that period.

- (2) This is the method statement for the purposes of paragraph (1)(a).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

*Method statement*

- Step 1. Work out the value of the particular matter as at each of the following measurement days:
- (a) the first day of the measurement period;
  - (b) the last day of each quarterly period of that income year (see subsection (3)) that occurs during the measurement period (if any);
  - (c) the last day of the measurement period if it is not a day covered by paragraph (b).
- Step 2. Add up those values.
- Step 3. Divide the result of step 2 by the number of measurement days. The result of this step is the average value.

Example: KJW Finance Corporation, a company that is an Australian entity, held assets valued at \$130 million on the first day of an income year. On the last day of each quarterly period for that year it held assets valued at \$140 million, \$120 million, \$110 million and \$100 million respectively. Adding these amounts and dividing the result by 5 gives the average value of its assets for that year, which is \$120 million.

*Quarterly period*

- (3) The **quarterly periods of the income year** are:
- (a) the period consisting of the first, second and third months of that year; and
  - (b) each successive period of 3 months that occurs after that period during that year.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (4) This is the method statement for the purposes of paragraph (1)(b):

*Method statement*

- Step 1. Work out the value of the particular matter as at each of the following measurement days:
- (a) the first day of the measurement period;
  - (b) the last day of each regular interval for the measurement period (see subsection (5));
  - (c) the last day of the measurement period if it is not a day mentioned in paragraph (b).
- Step 2. Add up those values.
- Step 3. Divide the result of step 2 by the number of measurement days. The result of this step is the average value.

Example: TW Corporation, a company that is an Australian entity, adopts a weekly interval for the purposes of this subsection. The measurement period is a period of 12 weeks. On the first day of that period it had \$70 million of debt capital. Its debt capital was \$80 million on the last day of each of the first 7 weeks, and \$95 million on the last day of the remaining 5 weeks. Adding these amounts and dividing the result by 13 (the number of measurement days) gives the average value of its debt capital for that period, which is \$85 million.

*Regular intervals*

- (5) The **regular intervals** for the measurement period are:
- (a) a period which consists of a fixed number of days or months (not less than one day and not more than 3 months) adopted by the entity and begins at the start of the first day of the measurement period; and
  - (b) each successive period of the same duration that occurs during the measurement period.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Note: Examples of a regular interval therefore include a daily, weekly, fortnightly, monthly or quarterly interval.

- (6) The entity must use the same regular intervals when calculating the average values of different matters under subsection (4) for that period.

## **Special rules about values and valuation**

### **820-675 Amount to be expressed in Australian currency**

- (1) For the purposes of this Division, an amount (including a value used in a calculation under this Division) is to be expressed in Australian currency.
- (2) An entity must comply with the \*accounting standards in converting an amount into Australian currency.
- (3) Subsection (2) has effect whether the \*accounting standard would otherwise apply to the entity or not.

### **820-680 Valuation of assets, liabilities and equity capital**

- (1) For the purposes of this Division, an entity must comply with the \*accounting standards in determining what are its assets and liabilities and in calculating:
- (a) the value of its assets; and
  - (b) the value of its liabilities (including its \*debt capital); and
  - (c) the value of its \*equity capital.

Note: This requirement to comply with the accounting standards is modified in certain cases (see sections 820-310 and 820-682).

- (1A) In particular, for the purposes of this Division, the entity has an asset or liability at a particular time if, and only if, according to the \*accounting standards, the asset or liability can or must be recognised at that time.

Note: This application of the accounting standards is modified in certain cases (see section 820-682).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-682

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(2) If:

- (a) an entity is required by an Australian law to prepare financial statements for a period in accordance with the \*accounting standards; and
- (b) a matter mentioned in subsection (1) is determined or calculated in accordance with the accounting standards for the purposes of the financial statements in relation to the period;

then, for the purposes of this Division, the matter is to be determined or calculated in relation to the period, or any part of the period, in the same way as it is determined or calculated in the financial statements.

(2A) If:

- (a) a period in relation to which a matter mentioned in subsection (1) is determined or calculated (the **current period**) is not the same as a period in relation to which paragraphs (2)(a) and (b) are satisfied; and
- (b) the current period overlaps with one or more periods in relation to which paragraphs (2)(a) and (b) are satisfied;

then, for the purposes of this Division, the matter is to be determined or calculated in relation to the current period in the same way as it is determined or calculated in the financial statements for the most recent of the overlapping periods.

*Accounting standards need not otherwise apply to the entity*

- (3) Subsection (1) has effect whether the \*accounting standard would otherwise apply to the entity or not.

**820-682 Recognition of assets and liabilities—modifying application of accounting standards**

*Deferred tax assets and deferred tax liabilities*

- (1) Despite subsections 820-680(1), (1A) and (2), an entity must not recognise:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-685

- (a) a deferred tax liability (within the meaning of the \*accounting standards) as a liability for the purposes of this Division; or
- (b) a deferred tax asset (within the meaning of the accounting standards) as an asset for the purposes of this Division.

Note: Subsections 820-680(1) and (1A) require compliance with accounting standards.

*Surpluses and deficits in defined benefit superannuation plans*

- (2) Despite subsections 820-680(1), (1A) and (2), an entity must not recognise an amount relating to a defined benefit plan (within the meaning of the \*accounting standards) as:
  - (a) a liability for the purposes of this Division; or
  - (b) an asset for the purposes of this Division.

Note: Subsections 820-680(1) and (1A) require compliance with accounting standards.

*Not applicable to ADIs*

- (3) This section does not apply in relation to an entity for a period if, for the period, the entity is an \*outward investing entity (ADI) or an \*inward investing entity (ADI).

*Not applicable to records about Australian permanent establishments*

- (4) This section does not apply for the purposes of section 820-960.

**820-685 Valuation of debt capital**

For the purposes of this Division, the regulations may make additional provisions for the valuation of the \*debt capital of an entity.

**820-690 Commissioner's power**

If the Commissioner considers that, in relation to a calculation under this Division, an entity has:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 820-740**

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- (a) overvalued its assets; or
  - (b) undervalued its liabilities (including its \*debt capital);
- the Commissioner may, having regard to the \*accounting standards and this Subdivision, substitute a value that the Commissioner considers is appropriate.

**Subdivision 820-H—Control of entities**

**Guide to Subdivision 820-H**

**820-740 What this Subdivision is about**

This Subdivision sets out rules about the following:

- the meaning of an Australian controller of a foreign entity (for the purpose of determining whether or not an entity is an outward investing entity (non-ADI) or outward investing entity (ADI));
- the meaning of a foreign controlled Australian entity (for the purpose of determining whether or not an entity is an inward investing entity (non-ADI));
- the method of working out the extent to which one entity is controlled by another entity for those purposes.

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**Australian controller of a foreign entity**

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- 820-750 What is an Australian controller of a controlled foreign company?
- 820-755 What is an Australian controller of a controlled foreign trust?
- 820-760 What is an Australian controller of a controlled foreign corporate limited partnership?

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Foreign controlled Australian entity**

- 820-780 What is a foreign controlled Australian entity?
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**Thin capitalisation control interest**

- 820-815 General rule about thin capitalisation control interest in a company, trust or partnership
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**TC direct control interest, TC indirect control interest and TC control tracing interest**

- 820-855 TC direct control interest in a company
- 820-860 TC direct control interest in a trust
- 820-865 TC direct control interest in a partnership
- 820-870 TC indirect control interest in a company, trust or partnership
- 820-875 TC control tracing interest in a company, trust or partnership

**Australian controller of a foreign entity****820-745 What is an Australian controlled foreign entity?**

An *Australian controlled foreign entity*, in relation to a particular time, is an entity that is any of the following at that time:

- (a) a \*controlled foreign company (except a \*corporate limited partnership);
- (b) a \*controlled foreign trust;
- (c) a \*controlled foreign corporate limited partnership.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-750

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**820-750 What is an Australian controller of a controlled foreign company?**

An entity is an *Australian controller* of a \*controlled foreign company mentioned in paragraph 820-745(a) at a particular time if, and only if, at that time:

- (a) that entity is an \*Australian entity holding a \*TC control interest in the controlled foreign company that is 10% or more; or
- (b) all of the following subparagraphs apply:
  - (i) the controlled foreign company is such a company because of paragraph 340(c) of the *Income Tax Assessment Act 1936*;
  - (ii) not more than 5 Australian entities, including that entity, control that controlled foreign company (either alone or together with \*associate entities and whether or not any associate entity is also an Australian entity);
  - (iii) that entity holds a \*TC control interest in the controlled foreign company that is at least 1%.

Note: A corporate limited partnership that is a foreign entity may be a controlled foreign corporate limited partnership, see section 820-760.

**820-755 What is an Australian controller of a controlled foreign trust?**

An entity is an *Australian controller* of a \*controlled foreign trust at a particular time if, and only if, at that time, the entity is an \*Australian entity holding a \*TC control interest in the trust that is 10% or more.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**820-760 What is an Australian controller of a controlled foreign corporate limited partnership?**

*Australian controller of a controlled foreign corporate limited partnership*

- (1) An entity is an **Australian controller** of a \*controlled foreign corporate limited partnership at a particular time if, and only if, at least one of the following paragraphs applies to the entity at that time:
- (a) the entity is an \*Australian entity that is a \*general partner of the partnership;
  - (b) the entity is an Australian entity holding a \*TC control interest in the partnership that is 10% or more.

*Controlled foreign corporate limited partnership*

- (2) A \*corporate limited partnership is a **controlled foreign corporate limited partnership** at a particular time if, and only if, at that time:
- (a) it is not an \*Australian entity; and
  - (b) at least one of the following subparagraphs applies to it:
    - (i) at least one \*general partner of the partnership is an \*Australian entity or an \*Australian controlled foreign entity;
    - (ii) not more than 5 Australian entities (each of which holds a \*TC control interest in the partnership that is at least 1%) hold a total of TC control interests in the partnership that is 50% or more.

**Foreign controlled Australian entity****820-780 What is a foreign controlled Australian entity?**

A **foreign controlled Australian entity**, in relation to a particular time, is an entity that is any of the following at that time:

- (a) a \*foreign controlled Australian company;
- (b) a \*foreign controlled Australian trust;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-785

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- (c) a \*foreign controlled Australian partnership.

**820-785 What is a foreign controlled Australian company?**

- (1) A company (except a \*corporate limited partnership) is a ***foreign controlled Australian company*** (or an ***FCAC***) at a particular time if, and only if, at that time, it is an \*Australian entity to which at least one of the following paragraphs applies:
- (a) not more than 5 \*foreign entities (each of which holds a \*TC control interest in the company that is at least 1%) hold a total of TC control interests in the company that is 50% or more;
  - (b) a foreign entity holds a TC control interest in the company that is 40% or more, and no other entity or entities (except an \*associate entity of the foreign entity or entities including the foreign entity or its associate entities) control the company;
  - (c) not more than 5 foreign entities control the company (whether or not with associate entities and whether or not any associate entity is a foreign entity).

Note: A corporate limited partnership that is an Australian entity may be a foreign controlled Australian partnership, see section 820-795.

*Exception*

- (2) Despite subsection (1), a company is not an FCAC at a particular time if, at that time:
- (a) the company would, apart from this subsection, be an FCAC only because of paragraph (1)(a) or (b); but
  - (b) the total of the following interests would be less than 20% if paragraphs 820-875(2)(a) and (b) were disregarded:
    - (i) the \*TC direct control interest in the company held by the \*foreign entity or entities mentioned in paragraph (1)(a) or (b);
    - (ii) the \*TC indirect control interest in the company held by the foreign entity or entities;
    - (iii) the TC direct control interests in the company held by any \*associate entities of the foreign entity or entities

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

(other than any TC direct control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii));

- (iv) the TC indirect control interests in the company held by the entity's associate entities (other than any TC indirect control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii)).

Note: Paragraphs 820-875(2)(a) and (b) set out special rules under which an entity is taken to hold a TC control tracing interest in another entity that is equal to 100%, which could then be taken into account in calculating a TC indirect control interest.

### 820-790 What is a foreign controlled Australian trust?

- (1) A trust is a **foreign controlled Australian trust** (or an **FCAT**) at a particular time if, and only if, at that time, it is an \*Australian trust to which at least one of the following paragraphs applies:
  - (a) not more than 5 \*foreign entities (each of which holds a \*TC control interest in the trust that is at least 1%) hold a total of TC control interests in the trust that is 50% or more;
  - (b) a foreign entity holds a TC control interest in the trust that is 40% or more, and no other entity or entities (except an \*associate entity of the foreign entity or entities including the foreign entity or its associate entities) control the trust;
  - (c) all of the following subparagraphs apply to the trust:
    - (i) at least one of the objects or beneficiaries of the trust is a foreign entity;
    - (ii) there has been at least one distribution of income or capital of the trust made to such an object or beneficiary (whether directly or indirectly) during the income year in which that particular time occurs, or during the preceding 2 income years;
    - (iii) the total TC control interests in the trust that are held by all its beneficiaries that are \*Australian entities do not exceed 50%;
  - (d) a foreign entity is in a position to control the trust (see subsection (2)).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-790

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- (2) A \*foreign entity is in a position to control a trust if, and only if:
- (a) the entity, or an \*associate entity of the entity, whether alone or with other associate entities (the **relevant entity**), has the power to obtain the beneficial enjoyment of the trust's capital or income (whether or not by exercising its power of appointment or revocation, and whether with or without another entity's consent); or
  - (b) the relevant entity is able to control the application of the trust's capital or income in any manner (whether directly or indirectly); or
  - (c) the relevant entity is able to do a thing mentioned in paragraph (a) or (b) under a \*scheme; or
  - (d) a trustee of the trust is accustomed or is under an obligation (whether formally or informally), or might reasonably be expected, to act in accordance with the relevant entity's directions, instructions or wishes; or
  - (e) the relevant entity is able to remove or appoint a trustee of the trust.

*Exception*

- (3) Despite subsection (1), a trust is not an FCAT at a particular time if, at that time:
- (a) the trust would, apart from this subsection, be an FCAT only because of paragraph (1)(a) or (b); but
  - (b) the total of the following interests would be less than 20% if paragraphs 820-875(2)(a) and (b) were disregarded:
    - (i) the \*TC direct control interest in the trust held by the \*foreign entity or entities mentioned in paragraph (1)(a), (b) or (c);
    - (ii) the \*TC indirect control interest in the trust held by the foreign entity or entities;
    - (iii) the TC direct control interests in the trust held by any \*associate entities of the foreign entity or entities (other than any TC direct control interests that have been taken

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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into account in calculating the interest mentioned in subparagraph (ii));

- (iv) the TC indirect control interests in the trust held by the entity's associate entities (other than any TC indirect control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii)).

Note: Paragraphs 820-875(2)(a) and (b) set out special rules under which an entity is taken to hold a TC control tracing interest in another entity that is equal to 100%, which could then be taken into account in calculating a TC indirect control interest.

## **820-795 What is a foreign controlled Australian partnership?**

### *Corporate limited partnership*

- (1) A \*corporate limited partnership is a **foreign controlled Australian partnership** (or an **FCAP**) at a particular time if, and only if, at that time:
  - (a) it is an \*Australian entity; and
  - (b) at least one of the following subparagraphs applies to it:
    - (i) not more than 5 \*foreign entities (each of which holds a \*TC control interest in the partnership that is at least 1%) hold a total of TC control interests in the partnership that are 50% or more;
    - (ii) at least one \*general partner of the partnership is a foreign entity or a \*foreign controlled Australian entity.

### *Partnership that is not a corporate limited partnership*

- (2) A partnership other than a \*corporate limited partnership is a **foreign controlled Australian partnership** (or an **FCAP**) at a particular time if, and only if, at that time:
  - (a) at least one of the partners is an \*Australian entity; and
  - (b) at least one of the following subparagraphs applies to it:
    - (i) not more than 5 \*foreign entities (each of which holds a \*TC control interest in the partnership that is at least

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 820-795**

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1%) hold a total of TC control interests in the partnership that is 50% or more;

- (ii) a foreign entity holds a TC control interest in the partnership that is 40% or more, and no other entity or entities (except an \*associate entity of the foreign entity or entities including the foreign entity or its associate entities) control the partnership.

*Exception*

- (3) Despite subsections (1) and (2), a partnership is not an FCAP at a particular time if, at that time:
  - (a) the partnership would, apart from this subsection, be an FCAP only because of subparagraph (1)(b)(i), (2)(b)(i) or (ii); but
  - (b) the total of the following interests would be less than 20% if paragraphs 820-875(2)(a) and (b) were disregarded:
    - (i) the \*TC direct control interest in the partnership held by the \*foreign entity or entities mentioned in subparagraph (1)(b)(i), (2)(b)(i) or (ii);
    - (ii) the \*TC indirect control interest in the partnership held by the foreign entity or entities;
    - (iii) the TC direct control interests in the partnership held by any \*associate entities of the foreign entity or entities (other than any TC direct control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii));
    - (iv) the TC indirect control interests in the partnership held by the entity's associate entities (other than any TC indirect control interests that have been taken into account in calculating the interest mentioned in subparagraph (ii)).

Note: Paragraphs 820-875(2)(a) and (b) set out special rules under which an entity is taken to hold a TC control tracing interest in another entity that is equal to 100%, which could then be taken into account in calculating a TC indirect control interest.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Thin capitalisation control interest****820-815 General rule about thin capitalisation control interest in a company, trust or partnership***Meaning of TC control interest*

- (1) The ***thin capitalisation control interest*** (or ***TC control interest***) that an entity holds in a company, trust or partnership at a particular time is the total of the following interests:
- (a) the \*TC direct control interest (if any) held by the entity in the company, trust or partnership at that time;
  - (b) the \*TC indirect control interest (if any) held by the entity in the company, trust or partnership at that time;
  - (c) the TC direct control interests (if any) held by the entity's \*associate entities in the company, trust or partnership at that time;
  - (d) the TC indirect control interests (if any) held by the entity's associate entities in the company, trust or partnership at that time.

This section has effect subject to sections 820-820 to 820-835 (which set out special rules to avoid double counting).

Note: For the rules about a TC direct control interest, see sections 820-855 to 820-865. For the rules about a TC indirect control interest, see sections 820-870 to 820-875.

- (2) This section does not apply to an \*associate entity of the entity if:
- (a) the associate entity is a \*foreign entity and the associate entity is such an associate entity only because of subsection 820-905(3A); or
  - (b) the associate entity is such an associate entity only because of subsection 820-905(3B).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-820

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**820-820 Special rules about calculating TC control interest held by an entity**

- (1) This section applies for the purposes of calculating the \*TC control interest that an entity holds in a company, trust or partnership.
- (2) Disregard a \*TC indirect control interest held by the entity to the extent to which it is calculated by reference to:
  - (a) a \*TC direct control interest taken into account under paragraph 820-815(c); or
  - (b) a TC indirect control interest taken into account under paragraph 820-815(d).
- (3) Disregard a \*TC indirect control interest held by an \*associate entity of the entity to the extent to which it is calculated by reference to:
  - (a) a \*TC direct control interest taken into account under paragraph 820-815(a) or (c); or
  - (b) a TC indirect control interest taken into account under paragraph 820-815(b) or (d).
- (3A) Subsection (3) does not apply to an \*associate entity of the entity if:
  - (a) the associate entity is a \*foreign entity and the associate entity is such an associate entity only because of subsection 820-905(3A); or
  - (b) the associate entity is such an associate entity only because of subsection 820-905(3B).
- (4) Take into account only one of the following things if both would otherwise be counted in calculating the \*TC control interest:
  - (a) the holding of a \*TC direct control interest by the entity or any other entity;
  - (b) an entitlement to acquire that TC direct control interest.
- (5) The operation of this section in relation to an entity does not prevent the operation of section 820-825 in relation to a group of entities that includes that entity.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**820-825 Special rules about calculating TC control interests held by a group of entities**

- (1) This section applies for the purposes of calculating the total \*TC control interests that a group of entities holds in a company, trust or partnership.
- (2) Take into account a particular \*TC direct control interest or \*TC indirect control interest only once if it would otherwise be counted more than once because the entity holding it is an \*associate entity of one or more entities in the group.
- (2A) Subsection (2) does not apply to an \*associate entity of one or more entities in the group if:
  - (a) the associate entity is a \*foreign entity and the associate entity is such an associate entity only because of subsection 820-905(3A); or
  - (b) the associate entity is such an associate entity only because of subsection 820-905(3B).
- (3) Take into account only one of the following things if both of them would otherwise be counted in calculating the total \*TC control interests:
  - (a) the holding of a \*TC direct control interest by an entity;
  - (b) an entitlement to acquire that TC direct control interest.
- (4) The operation of this section in relation to a group of entities does not prevent the operation of section 820-820 in relation to an entity that is a member of that group.

**820-830 Special rules about determining percentage of TC control interest**

- (1) This section applies for the purposes of determining whether an entity, or a group of entities, holds at least a particular percentage of \*TC control interests for the purposes of a provision in this Subdivision.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-835

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- (2) If, apart from this subsection, an entity, or each of 2 or more entities, would hold a \*TC direct control interest equal to 100%, or a \*TC control tracing interest equal to 100%, in another entity (the *controlled entity*):
- (a) only the entity, or one of the 2 or more entities, is to be taken to hold that particular interest in the controlled entity equal to 100%; and
  - (b) another entity is not to be taken to hold that particular interest in the controlled entity (whether or not it would, apart from this subsection, hold that interest in the controlled entity equal to 100%).

**820-835 Commissioner's power**

For the purposes of this Subdivision, the Commissioner may decide:

- (a) which one of 2 things is to be taken into account for the purposes of subsection 820-820(4) or subsection 820-825(3); or
- (b) which one of 2 or more entities is to be chosen for the purposes of paragraph 820-830(2)(a).

**TC direct control interest, TC indirect control interest and TC control tracing interest**

**820-855 TC direct control interest in a company**

- (1) A *thin capitalisation direct control interest* (or a *TC direct control interest*) that an entity holds in a company (except a \*corporate limited partnership) at a particular time is the percentage of the direct control interest (if any) that the entity holds in the company at that time under the provisions applied by subsection (2).

Note: For the TC direct control interest that an entity holds in a corporate limited partnership, see section 820-865.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 820-860

- (2) For the purposes of subsection (1), provisions of Part X of the *Income Tax Assessment Act 1936* are applied with the modifications set out in the following table.

<b>Modifications of provisions in Part X of the <i>Income Tax Assessment Act 1936</i></b>		
<b>Item</b>	<b>Provisions</b>	<b>Modifications</b>
1	Section 350 (including any other provision in Part X of the <i>Income Tax Assessment Act 1936</i> that defines a term used in the section)	The section applies for the purposes of this Subdivision rather than only for the purposes of Part X of the <i>Income Tax Assessment Act 1936</i>
2	Subsections 350(6) and (7)	<p>If section 350 is used for the purposes of determining whether or not a company is a *foreign controlled Australian company, the subsections apply as if subsection (6) referred to *foreign entities and foreign entity rather than *Australian entities and Australian entity</p> <p>If section 350 is used for the purposes of determining whether or not an entity is an *Australian controller of a *controlled foreign company, the subsections do not apply</p>
3	Section 350	A reference to an *associate is taken to be a reference to an *associate entity

**820-860 TC direct control interest in a trust**

- (1) A *thin capitalisation direct control interest* (or a *TC direct control interest*) that an entity holds in a trust at a particular time is the percentage of the direct control interest (if any) that the entity holds in the trust at that time under the provisions applied by subsection (2).
- (2) For the purposes of subsection (1), provisions of Part X of the *Income Tax Assessment Act 1936* are applied with the modifications set out in the following table.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 820-865

**Modifications of provisions in Part X of the *Income Tax Assessment Act 1936***

Item	Provisions	Modifications
1	Section 351 (including any other provision in Part X of the <i>Income Tax Assessment Act 1936</i> that defines a term used in the section)	The section applies for the purposes of this Subdivision rather than only for the purposes of Part X of the <i>Income Tax Assessment Act 1936</i>
2	Subsections 351(3) and (4)	The subsections do not apply

- (3) In addition, for the purposes of determining whether or not an entity (other than a trust mentioned in paragraph (a) or (b)) is a \*foreign controlled Australian entity:
- (a) if a trust is covered by paragraph 820-790(1)(c)—a foreign entity that is an object of the trust at a particular time is taken to hold, at that time, a TC direct control interest in the trust that is equal to 100%; and
  - (b) if a trust is covered by paragraph 820-790(1)(d)—a foreign entity that is in a position to control the trust at a particular time is taken to hold, at that time, a \*TC direct control interest in the trust that is equal to 100%.

Note: The foreign entity therefore holds a TC control tracing interest in the trust (see section 820-875). That interest may then be taken into account in calculating any TC indirect control interest that the foreign entity holds in another entity in relation to which the trust is an interposed entity (see section 820-870). As a result, that other entity may become a foreign controlled Australian entity.

**820-865 TC direct control interest in a partnership**

A ***thin capitalisation direct control interest*** (or a ***TC direct control interest***) that an entity holds in a partnership at a particular time is whichever of the following percentages is applicable, and if there are 2 or more such percentages, the greatest of them:

- (a) in the case of a \*corporate limited partnership—100% if the entity is a \*general partner of the partnership;

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (b) in the case of a partnership that is not a corporate limited partnership—the percentage of the control of voting power in the partnership that the entity has at that time;
- (c) in any case—the percentage that the entity holds, or is entitled to acquire, at that time, of any of the following:
  - (i) the total amount of assets or capital contributed to the partnership;
  - (ii) the total rights of partners to distributions of capital, assets or profits on the dissolution of the partnership;
  - (iii) the total rights of partners to distributions of capital, assets or profits otherwise than on the dissolution of the partnership.

### **820-870 TC indirect control interest in a company, trust or partnership**

*What is a TC indirect control interest?*

- (1) An entity holds a ***thin capitalisation indirect control interest*** (or a ***TC indirect control interest***) in a company, trust or partnership at a particular time if, and only if:
  - (a) there is an interposed entity, or a continuous series of at least 2 interposed entities, between that entity and the company, trust or partnership; and
  - (b) the interposed entity, or each of the interposed entities, is:
    - (i) a \*foreign controlled Australian entity if this section is used for the purposes of determining whether or not an entity is a foreign controlled Australian entity; or
    - (ii) an \*Australian controlled foreign entity if this section is used for the purposes of determining whether or not an entity is an Australian controlled foreign entity or an \*Australian controller of such an entity.

Note: In the case of a continuous series of interposed entities between an entity and a company, trust or partnership, the entity must hold a TC control tracing interest in the first interposed entity (see subsection (2)). In addition, under subsection (2), each interposed entity in the series must hold a TC control tracing interest in the next

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-870

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interposed entity (except in the case of the last one, which holds a TC control tracing interest in the company, trust or partnership).

*What is an interposed entity?*

- (2) For the purposes of this section, an entity (the ***middle entity***) is interposed between 2 other entities at a particular time if, and only if, at that time:
- (a) the first of those 2 entities holds a \*TC control tracing interest in the middle entity; and
  - (b) the middle entity holds a TC control tracing interest in the second of those 2 entities.

Note: For the rules about a TC control tracing interest, see section 820-875.

*How to calculate a TC indirect control interest*

- (3) The \*TC indirect control interest that an entity (the ***top entity***) holds in a company, trust or partnership at a particular time is calculated in accordance with subsection (4), (5) or (6) (as appropriate).

*One interposed entity only*

- (4) The \*TC indirect control interest is the result of applying the following method statement if there is only one interposed entity between the top entity and the company, trust or partnership at that time.

*Method statement*

- Step 1. Calculate the \*TC control tracing interest that the top entity holds in the interposed entity at that time.
- Step 2. Multiply the result of step 1 by the \*TC control tracing interest that the interposed entity holds in the company, trust or partnership at that time.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*2 interposed entities*

- (5) The \*TC indirect control interest is the result of applying the following method statement if there are 2 interposed entities between the top entity and the company, trust or partnership at that time.

*Method statement*

- Step 1. Calculate the \*TC control tracing interest that the top entity holds in the first of those interposed entities at that time.
- Step 2. Multiply the result of step 1 by the \*TC control tracing interest that the first interposed entity holds in the next interposed entity (the ***second interposed entity***) at that time.
- Step 3. Multiply the result of step 2 by the \*TC control tracing interest that the second interposed entity holds in the company, trust or partnership at that time.

*More than 2 interposed entities*

- (6) The \*TC indirect control interest is the result of applying the following method statement if there are more than 2 interposed entities between the top entity and the company, trust or partnership at that time.

*Method statement*

- Step 1. Calculate the \*TC control tracing interest that the top entity holds in the first of those interposed entities at that time.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- Step 2. Multiply the result of step 1 by the \*TC control tracing interest that the first interposed entity holds in the next interposed entity (the ***second interposed entity***) at that time.
- Step 3. Multiply the result of step 2 by the \*TC control tracing interest that the second interposed entity holds in the next interposed entity at that time.
- Step 4. Continue this pattern of multiplying the result of the last multiplication by the \*TC control tracing interest in the next interposed entity held by the preceding entity, ending with a multiplication by the TC control tracing interest held by the last interposed entity in the company, trust or partnership.

**820-875 TC control tracing interest in a company, trust or partnership**

- (1) A ***thin capitalisation control tracing interest*** (or a ***TC control tracing interest***) that an entity holds in a company, trust or a partnership at a particular time is equal to the \*TC direct control interest in the company, trust or partnership that the entity holds at that time.
- (2) Despite subsection (1), an entity is taken to hold a \*TC control tracing interest in a company, trust or partnership that is equal to 100% at a particular time if, at that time:
- (a) the entity and its \*associate entities hold a total of \*TC direct control interests in the company, trust or partnership that is 50% or more; or
  - (b) the following subparagraphs apply:
    - (i) the entity (the ***controlling entity***) and its associate entities hold a total of TC direct control interests that is 40% or more in the company, trust or partnership;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) no other entity or entities (except the controlling entity, its associate entities or entities including the controlling entity or its associate entities) control the company, trust or partnership; or
  - (c) the entity (whether or not together with associate entities) controls the company, trust or partnership.
- (3) Paragraph (2)(b) does not apply if the \*TC direct control interests mentioned in subparagraph (2)(b)(i) are held in a \*corporate limited partnership.

## Subdivision 820-HA—Controlled foreign entity debt and controlled foreign entity equity

### Guide to Subdivision 820-HA

#### 820-880 What this Subdivision is about

Controlled foreign entity debt and controlled foreign entity equity are concepts used in this Division. This Subdivision sets out the meaning of each of these concepts.

#### Table of sections

820-881	Application
820-885	What is <i>controlled foreign entity debt</i> ?
820-890	What is <i>controlled foreign entity equity</i> ?

#### 820-881 Application

This Subdivision applies to:

- (a) an entity (the **relevant entity**) that is an \*outward investing entity (non-ADI), or an \*outward investing entity (ADI), for a period (the **relevant period**) that is all or a part of an income year; and
- (b) each entity (**controlled entity of the relevant entity**) that is an \*Australian controlled foreign entity of which:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (i) the relevant entity is an \*Australian controller; or
- (ii) an \*associate entity of the relevant entity is an Australian controller.

**820-885 What is *controlled foreign entity debt*?**

- (1) The relevant entity's ***controlled foreign entity debt*** at a particular time during the relevant period is the total value of all the \*debt interests held by the relevant entity at that time that satisfy all of the following:
  - (a) the interests are \*on issue at that time;
  - (b) each of the interests was \*issued by an entity that is a controlled entity of the relevant entity at that time;
  - (c) each of the interests gives rise to a cost, at any time, that is covered by paragraph 820-40(1)(a).
- (2) For the purposes of subsection (1), take into account the value of a \*debt interest issued by a controlled entity of the relevant entity only to the extent that the interest is *not* attributable to any of the following assets that are held by the controlled entity throughout the relevant period:
  - (a) assets attributable to the controlled entity's \*Australian permanent establishments;
  - (b) other assets that are held by the controlled entity for the purposes of producing assessable income of the controlled entity.

**820-890 What is *controlled foreign entity equity*?**

- (1) The relevant entity's ***controlled foreign entity equity*** at a particular time during the relevant period is the total value of:
  - (a) all the \*equity interests that the entity holds, at that time, in entities that are controlled entities of the relevant entity at that time; and
  - (b) all the \*debt interests \*on issue and held by the entity at that time that satisfy both of the following:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (i) the interests were \*issued by entities that are controlled entities of the relevant entity at that time;
  - (ii) none of the interests gives rise to any cost, at any time, that is covered by paragraph 820-40(1)(a).
- (2) For the purposes of subsection (1), take into account the value of an \*equity interest in, or a \*debt interest issued by, a controlled entity of the relevant entity only to the extent that the interest is *not* attributable to any of the following assets that are held by the controlled entity throughout the relevant period:
  - (a) assets attributable to the controlled entity's \*Australian permanent establishments;
  - (b) other assets that are held by the controlled entity for the purposes of producing assessable income of the controlled entity.

**Subdivision 820-I—Associate entities****Guide to Subdivision 820-I****820-900 What this Subdivision is about**

This Subdivision sets out the meaning of various concepts about associate entities for the purposes of this Division.

**Table of sections**

820-905	Associate entity
820-910	Associate entity debt
820-915	Associate entity equity
820-920	Associate entity excess amount

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-905

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**820-905 Associate entity**

*Meaning of associate entity*

- (1) An entity (the **first entity**) that is not an individual is an **associate entity** of another entity at a particular time if, at that time, the first entity is an \*associate of that other entity and at least one of the following paragraphs applies:
- (a) that other entity holds an \*associate interest of 50% or more in the first entity (see subsections (4) to (8));
  - (b) the first entity is accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or wishes of that other entity in relation to:
    - (i) the distribution or retention of the first entity's profits; or
    - (ii) the financial policies relating to the first entity's assets, \*debt capital or \*equity capital;whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed entities.
- However, this subsection does not apply to the first entity in its capacity as the \*responsible entity of a \*registered scheme (see subsection (2A)).
- (2) An entity (the **first entity**) that is an individual is an **associate entity** of another entity at a particular time if, at that time:
- (a) the first entity is an \*associate of that other entity; and
  - (b) the first entity:
    - (i) is accustomed or under an obligation (whether formal or informal); or
    - (ii) might reasonably be expected; to act in accordance with the directions, instructions or wishes of that other entity in relation to the first entity's financial affairs, whether those directions, instructions or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

wishes are, or might reasonably be expected to be, communicated directly or through interposed entities.

(2A) An entity (the **first entity**), in its capacity as the \*responsible entity of a \*registered scheme at a particular time, is an **associate entity** of another entity at that time if the first entity, in that capacity, is an \*associate of that other entity at that time and at least one of the following paragraphs applies at that time:

- (a) that other entity holds an \*associate interest of 50% or more in the registered scheme (see subsections (4) to (8));
- (b) that other entity holds an associate interest of 20% or more in the registered scheme and the first entity, in that capacity, is accustomed or under an obligation (whether formal or informal), or might reasonably be expected, to act in accordance with the directions, instructions or wishes of that other entity in relation to:
  - (i) the distribution or retention of the profits of the registered scheme; or
  - (ii) the financial policies relating to the assets, \*debt capital or \*equity capital of the registered scheme;

whether those directions, instructions or wishes are, or might reasonably be expected to be, communicated directly or through interposed entities.

Note: The first entity, in another capacity, may also be an associate entity of an entity under another provision of this section (see also section 960-100).

(2B) For the purposes of sections 820-910, 820-915 and 820-920, if the first entity mentioned in subsection (1) or (2A) is a trust (other than a \*public trading trust) or a partnership:

- (a) treat the reference in paragraph (1)(a) or (2A)(a) to 50% as instead being a reference to 10%; and
- (b) if subsection (2C) applies—treat the other entity mentioned in subsection (1) or (2A) as holding an \*associate interest in the first entity mentioned in that subsection of 10%; and
- (c) disregard subsection 318(5) of the *Income Tax Assessment Act 1936*; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-905

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- (d) if subsection (2D) applies—in determining whether an entity is an \*associate of another entity, treat the benefiting entity mentioned in that subsection as being a partner in the partnership.
- (2C) This subsection applies if:
- (a) the other entity mentioned in subsection (1) or (2A) holds an \*associate interest in the first entity mentioned in that subsection of less than 10%; and
  - (b) it is reasonable to conclude that the entity, or one of the entities, who created the circumstance described in paragraph (a) of this subsection did so for the principal purpose of, or for more than one principal purpose that included the purpose of, ensuring that the first entity will not be an \*associate entity of the other entity.
- (2D) This subsection applies if:
- (a) a trust (other than a \*public trading trust) is a partner in a partnership; and
  - (b) another entity (the **benefiting entity**) benefits under the trust (as determined in accordance with paragraph 318(6)(a) of the *Income Tax Assessment Act 1936*).
- (3) Subsection (1) or (2A) also has effect as if the first entity satisfies paragraph (b) of that subsection at a particular time if any of the following is expected to act in the manner mentioned in that paragraph at that time:
- (a) a director of the first entity if it is a company;
  - (b) a partner of the first entity if it is a partnership;
  - (c) the \*general partner of the first entity if it is a \*corporate limited partnership;
  - (d) the trustee of the first entity if it is a trust;
  - (e) a member of the first entity's committee of management if it is an unincorporated association or body.
- (3A) If:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) an entity (the ***first entity***) is an \*associate entity of another entity (the ***head entity***) under subsection (1), (2), (2A) or (3) at a particular time; and
  - (b) a third entity is also an associate entity of the head entity under subsection (1), (2), (2A) or (3) at that time;
- the first entity is an ***associate entity*** of the third entity at that time.
- (3B) If an entity (the ***first entity***) is an \*associate entity of another entity under subsection (1), (2), (2A), (3) or (3A) at a particular time, that other entity is also an ***associate entity*** of the first entity at that time.
- (3C) However, an entity in its capacity as the \*responsible entity of a \*registered scheme (the ***responsible entity***) is not an \*associate entity of another entity under subsection (3B) at a particular time if, at that time, the responsible entity:
- (a) would be an associate entity of that other entity under subsection (3B) (apart from the effect of this subsection); but
  - (b) is not an associate entity of that other entity under subsection (2A).

*Associate interest in a company (except a corporate limited partnership)*

- (4) An ***associate interest*** that an entity holds in a company (except a \*corporate limited partnership) at a particular time is the percentage of the direct control interest (if any) that the entity holds in the company at that time under the provisions applied by subsection (5).
- (5) For the purposes of subsection (4), provisions of Part X of the *Income Tax Assessment Act 1936* are applied with the modifications set out in the following table:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 820-905

**Modifications of provisions in Part X of the *Income Tax Assessment Act 1936***

Item	Provisions	Modifications
1	Section 350 (including any other provision in Part X of the <i>Income Tax Assessment Act 1936</i> that defines a term used in the section)	The section applies for the purposes of this subsection rather than only for the purposes of Part X of the <i>Income Tax Assessment Act 1936</i>
2	Subsections 350(6) and (7)	The subsections do not apply

*Associate interest in a trust*

- (6) An **associate interest** that an entity holds in a trust at a particular time is the percentage of the direct control interest (if any) that the entity holds in the trust at that time under the provisions applied by subsection (7).
- (7) For the purposes of subsection (6), provisions of Part X of the *Income Tax Assessment Act 1936* are applied with the modifications set out in the following table:

**Modifications of provisions in Part X of the *Income Tax Assessment Act 1936***

Item	Provisions	Modifications
1	Section 351 (including any other provision in Part X of the <i>Income Tax Assessment Act 1936</i> that defines a term used in the section)	The section applies for the purposes of this subsection rather than only for the purposes of Part X of the <i>Income Tax Assessment Act 1936</i>
2	Subsections 351(3) and (4)	The subsections do not apply

*Associate interest in a partnership*

- (8) An **associate interest** that an entity holds in a partnership at a particular time is whichever of the following percentages is applicable, and if there are 2 or more such percentages, the greatest of them:

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-910

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- (a) in the case of a \*corporate limited partnership—100% if the entity is a \*general partner of the partnership;
- (b) in the case of a partnership that is not a corporate limited partnership—the percentage of the control of voting power in the partnership that the entity has at that time;
- (c) in any other case—the percentage that the entity holds, or is entitled to acquire, at that time, of any of the following:
  - (i) the total amount of assets or capital contributed to the partnership;
  - (ii) the total rights of partners to distributions of capital, assets or profits on the dissolution of the partnership;
  - (iii) the total rights of partners to distributions of capital, assets or profits otherwise than on the dissolution of the partnership.

**820-910 Associate entity debt**

- (1) This section applies to an entity (the **relevant entity**) that is an \*outward investing entity (non-ADI), or an \*inward investing entity (non-ADI), for a period (the **relevant period**) that is all or a part of an income year.
- (2) This section also applies, for the relevant entity, to an \*associate entity (a **relevant associate entity**) of the relevant entity, if:
  - (a) either:
    - (i) the associate entity is an \*outward investing entity (non-ADI), an \*inward investment vehicle (general), or an \*inward investment vehicle (financial), for the relevant period; or
    - (ii) the associate entity is an \*inward investor (general) or an \*inward investor (financial) for the relevant period, and the condition in subsection (2A) of this section is satisfied; and
  - (b) neither section 820-35 (\$2 million debt deductions threshold) nor section 820-37 (exemption for entity with 90% Australian assets) prevents Subdivision 820-B, 820-C, 820-D

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-910

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- or 820-E from disallowing any \*debt deduction of the relevant associate entity for the income year; and
- (c) for some or all of the relevant period, the relevant associate entity does *not* meet the conditions in subsection 820-39(3) (about exemption of certain special purpose entities); and
  - (d) the relevant associate entity is not an \*exempt entity for the income year.
- (2A) The condition referred to in subparagraph (2)(a)(ii) is that the relevant period consists of one or more periods each of which is either or both of these:
- (a) a period throughout which the \*associate entity carries on its \*business in Australia at or through one or more of its \*Australian permanent establishments;
  - (b) a period throughout which the associate entity holds any of the following assets:
    - (i) assets that are attributable to the associate entity's Australian permanent establishments;
    - (ii) other assets that are held for the purposes of producing the associate entity's assessable income.
- (3) The relevant entity's **associate entity debt** at a particular time during the relevant period is the total value of all the \*debt interests held by the relevant entity at that time that satisfy all of the following:
- (a) the interests are \*on issue at that time;
  - (b) each of the interests was \*issued by a relevant associate entity;
  - (c) each of the interests gives rise to costs:
    - (i) that are \*debt deductions, for an income year, of the relevant associate entity that issued the interest; and
    - (ii) to the extent that the costs are not amounts mentioned in paragraph 820-40(2)(c) and are costs ordinarily payable to an entity other than the relevant entity—that are assessable income of the relevant entity for an income year;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (d) the terms and conditions for each of the interests are those that would apply if the relevant entity and the relevant associate entity that issued the interest were dealing at \*arm's length with each other.
- (4) For the purposes of subsection (3), take into account the value of a \*debt interest issued by a \*foreign entity only to the extent that the interest is attributable to any of the following assets that are held by the foreign entity throughout the relevant period:
  - (a) assets that are attributable to the foreign entity's \*Australian permanent establishments;
  - (b) other assets held by the foreign entity for the purposes of producing the foreign entity's assessable income.

### **820-915 Associate entity equity**

- (1) This section applies to an entity (the **relevant entity**) that is an \*outward investing entity (non-ADI) or an \*inward investing entity (non-ADI) for a period (the **relevant period**) that is all or a part of an income year.
- (2) This section also applies, for the relevant entity, to each entity (**relevant associate entity**) that is an \*associate entity of the relevant entity and that is:
  - (a) an \*Australian entity; or
  - (b) a \*foreign entity that, throughout the relevant period, holds any of the following assets:
    - (i) assets that are attributable to the foreign entity's \*Australian permanent establishments;
    - (ii) other assets that are held for the purposes of producing the foreign entity's assessable income.
- (3) The relevant entity's **associate entity equity** at a particular time during the relevant period is the total value of:
  - (a) all the \*equity interests that the entity holds, at that time, in relevant associate entities; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-920

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- (b) all the \*debt interests \*on issue and held by the relevant entity at that time that satisfy all of the following:
    - (i) the interests were \*issued by relevant associate entities;
    - (ii) neither the value of each of the interests, nor any part of that value, is all or a part of any \*cost-free debt capital of the issuer of the interest at that time;
    - (iii) none of the interests gives rise to any cost, at any time, that is covered by paragraph 820-40(1)(a); and
  - (c) all the debt interests on issue and held by the relevant entity at that time that satisfy both of the following:
    - (i) the interests were issued by relevant associate entities;
    - (ii) each of the interests gives rise to a cost, at any time, that is covered by paragraph 820-40(1)(a), but the cost is not deductible from the assessable income of the issuer of the interest for any income year.
- (4) For the purposes of subsection (3), take into account the value of an \*equity interest in, or a \*debt interest issued by, a \*foreign entity only to the extent that the interest is attributable to assets covered by subparagraph (2)(b)(i) or (ii) that are held by the foreign entity throughout the relevant period.

**820-920 Associate entity excess amount**

- (1) This section applies to an entity (the **relevant entity**) that is an \*outward investing entity (non-ADI) or an \*inward investing entity (non-ADI) for a period that is all or a part of an income year.
- (2) The relevant entity's **associate entity excess amount** at a particular time during that period is the result of applying the method statement in this subsection.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Method statement*

- Step 1. Work out the premium excess amount (see subsection (3)), as at that particular time, for an \*associate entity of the relevant entity that is the issuer of an \*equity interest or a \*debt interest any value of which is all or a part of the relevant entity's \*associate entity equity at that time.
- Step 2. Add to the result of step 1 the attributable safe harbour excess amount (see subsection (4)) for that \*associate entity as at that time.
- Step 3. Apply steps 1 and 2 to all such \*associate entities of the relevant entity and add all the results that are positive amounts. The result of this step is the **associate entity excess amount**.

- (3) An \*associate entity's **premium excess amount** at a particular time during that period is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to an entity's \*overseas permanent establishments if it is an \*outward investing entity (non-ADI) at that time.

*Method statement*

- Step 1. Work out the value, as at that particular time, of all the \*associate entity equity of the relevant entity that is attributable to the \*associate entity (disregarding the value of any \*debt interest \*issued by the associate entity that is held by the relevant entity at that time).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 820-920

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- Step 2. Work out the value, as at that time, of all the \*equity capital of the \*associate entity that is attributable to \*equity interests that the relevant entity holds in the associate entity at that time (except equity interests whose value is all or a part of the relevant entity's \*controlled foreign entity equity at that time).
- Step 3. Reduce the result of step 1 by the result of step 2. However, if the result of step 2 is a negative amount, the result of step 2 is taken to be nil for the purpose of this step.
- Step 4. Multiply the result of step 3 by:
- (a)  $\frac{15}{16}$  if the \*associate entity excess amount is applied for the purpose of working out the \*total debt amount of the relevant entity for that period under subsection 820-100(2), 820-200(2) or 820-210(2); or
  - (b)  $\frac{3}{5}$  if the associate entity excess amount is applied for the purpose of working out the \*adjusted on-lent amount of the relevant entity for that period under subsection 820-100(3), 820-200(3) or 820-210(3); or
  - (c)  $\frac{3}{5}$  if the associate entity excess amount is applied for the purpose of working out the \*safe harbour debt amount of the relevant entity for that period under section 820-95, 820-195 or 820-205; or
  - (d) the result of step 4 of the method statement in subsection (1) or (2) of section 820-110 (as appropriate) if the associate entity excess amount is applied for the purpose of working out the \*worldwide gearing debt amount of the relevant entity for that period.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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The result of this step is the *premium excess amount*.

- (4) The \*associate entity's *attributable safe harbour excess amount* at a particular time during that period is the result of applying the method statement in this subsection. In applying the method statement, disregard any amount that is attributable to an entity's \*overseas permanent establishments if it is an \*outward investing entity (non-ADI) at that time.

*Method statement*

Step 1. Work out the \*safe harbour debt amount of the \*associate entity for the day during which that particular time occurs, as if:

- (a) the associate entity were an \*outward investing entity (non-ADI) or \*inward investing entity (non-ADI), as appropriate, for the period consisting only of that day; and
- (b) if the associate entity would otherwise be treated as an \*outward investor (financial) for that day and the relevant entity is not a \*financial entity throughout that day—the associate entity were an \*outward investor (general) for that day; and
- (c) if the associate entity would otherwise be treated as an \*inward investment vehicle (financial) for that day and the relevant entity is not a financial entity throughout that day—the associate entity were an \*inward investment vehicle (general) for that day; and

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 820-920**

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- (d) if the associate entity would otherwise be treated as an \*inward investor (financial) for that day and the relevant entity is not a financial entity throughout that day—the associate entity were an \*inward investor (general) for that day.

Step 2. Reduce the result of step 1 by the value of the \*adjusted average debt of the \*associate entity for that day as if it had been the kind of entity that it is taken to be under step 1 for that day. If the result of this step is a negative amount, it is taken to be nil.

Step 3. Multiply the result of step 2 by the sum of:

- (a) the value, as at that time, of all the \*equity capital of the \*associate entity that is attributable to the relevant entity at that time; and
- (b) the value, as at that time, of all the \*debt interests \*issued by the associate entity that are covered by subsection (5), and held by the relevant entity, at that time; and
- (c) the value, as at that time, of all the debt interests issued by the associate entity that are covered by subsection (6), and held by the relevant entity, at that time.

Step 4. Divide the result of step 3 by the sum of:

- (a) the value, as at that time, of all the \*equity capital of the \*associate entity; and
- (b) the value, as at that time, of all the \*debt interests \*issued by the associate entity that are covered by subsection (5) at that time; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (c) the value, as at that time, of all the debt interests issued by the associate entity that are covered by subsection (6) at that time.

(5) For the purposes of the method statement in subsection (4), this subsection covers a \*debt interest at a particular time if the interest satisfies all of the following:

- (a) the interest is \*on issue at that time;
- (b) neither the value of the interest, nor any part of that value, is all or a part of any \*cost-free debt capital of the issuer of the interest at that time;
- (c) the interest does not give rise to any cost, at any time, that is covered by paragraph 820-40(1)(a).

(6) For the purposes of the method statement in subsection (4), this subsection covers a \*debt interest at a particular time if the interest satisfies both of the following:

- (a) the interest is \*on issue at that time;
- (b) the interest gives rise to a cost, at any time, that is covered by paragraph 820-40(1)(a), but the cost is not deductible from the assessable income of the issuer of the interest for any income year.

## **Subdivision 820-J—Equity interest in a trust or partnership**

### **Guide to Subdivision 820-J**

#### **820-925 What this Subdivision is about**

This Subdivision provides for the meanings of an equity interest in a trust or partnership for the purposes of this Division.

#### **Table of sections**

820-930 *Equity interest* in a trust or partnership

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-930

**820-930 Equity interest in a trust or partnership**

*Application of provisions*

- (1) For the purposes of this Division and Division 230, an **equity interest** in an entity that is a trust or partnership has the meaning given by the provisions in Division 974 that are applied with the following modifications:

Modifications of Division 974		
Item	Provisions	Modifications
1	Subdivisions 974-C and 974-D	A reference in those provisions to a company is taken to be a reference to an entity that is a trust or a partnership
2	Subdivisions 974-C and 974-D	A reference in those provisions to the equity test in subsection 974-75(1) is taken to be a reference to the equity test in subsection (2) of this section
3	Section 974-75	The section does not apply and subsections (2) to (4) of this section apply instead
4	Section 974-80	The example does not apply
5	Section 974-95	A reference in those provisions to the table in subsection 974-75(1) is taken to be a reference to the table in subsection (2) of this section
6	Subsection 974-95(4)	The subsection does not apply
7	Subdivision 974-F	The Subdivision applies for the purposes of this section
8	Subdivisions 974-C, 974-D and 974-F	A reference in those provisions to the regulations is taken to be a reference to the regulations made under the provisions applied by this subsection
Note: An interest that satisfies both the equity test and the debt test set out in Subdivision 974-B is treated as a debt interest and not an equity interest (see that Subdivision in conjunction with the provisions applied by subsection (1)).		

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

*Equity tests*

- (2) A \*scheme satisfies the equity test in this subsection in relation to an entity that is a trust or partnership if the scheme gives rise to an interest set out in the following table:

<b>Equity interests</b>	
<b>Item</b>	<b>Interest</b>
1	In the case of a trust, an interest as a beneficiary of the trust In the case of a partnership, an interest as a partner in the partnership
2	An interest that carries a right to a variable or fixed return from the entity if either the right itself, or the amount of the return, is in substance or effect *contingent on aspects of the economic performance (whether past, current or future) of: (a) the entity; or (b) a part of the entity's activities; or (c) an *associate of the entity or a part of the activities of an associate of the entity The return may be a return of an amount invested in the interest
3	An interest that carries a right to a variable or fixed return from the entity if either the right itself, or the amount of the return, is at the discretion of: (a) the entity; or (b) an *associate of the entity The return may be a return of an amount invested in the interest
4	An *interest issued by the entity that: (a) gives its holder (or an *associate of the holder) a right to be issued with an *equity interest in the entity or an associate of the entity; or (b) is an interest that will, or may, convert into an equity interest in the entity or an associate of the entity

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 820-930**

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This subsection has effect subject to subsection (3) (requirement for financing arrangement).

Note: Section 974-90 as applied by subsection (1) allows regulations to be made clarifying when a right or return is taken to be at the discretion of an entity or an associate.

*Financing arrangement*

- (3) A \*scheme that would otherwise give rise to an \*equity interest in an entity that is a trust or partnership because of an item in the table in subsection (2) (other than item 1) does not give rise to an equity interest in the entity unless the scheme is a \*financing arrangement (see section 974-130 as applied by this section) for the trust or partnership.

*Form interest may take*

- (4) The interest referred to in item 2, 3 or 4 in the table in subsection (2) may take the form of a proprietary right, a chose in action or any other form.

*Regulations*

- (5) Subject to regulations made under subsection (6), the regulations made under Subdivisions 974-C, 974-D and 974-F are applied for the purposes of this section as if they were regulations made under the provisions applied by subsection (1).
- (6) Regulations may be made under the provisions applied by subsection (1) specifically in relation to:
- (a) an \*equity interest in a trust; or
  - (b) an equity interest in a partnership.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Subdivision 820-JA—Worldwide debt and equity concepts****Guide to Subdivision 820-JA****820-931 What this Subdivision is about**

This Subdivision provides for the meanings of worldwide debt, worldwide equity, statement worldwide debt, statement worldwide equity and statement worldwide assets.

**Table of sections****Operative provisions**

820-932	Worldwide debt and worldwide equity
820-933	Statement worldwide debt, statement worldwide equity and statement worldwide assets
820-935	Requirements for audited consolidated financial statements

**Operative provisions****820-932 Worldwide debt and worldwide equity***Worldwide debt*

- (1) An entity's **worldwide debt** at a particular time, means the total of the following amounts:
- (a) all the \*debt interests issued by the entity:
    - (i) to entities other than any \*Australian controlled foreign entities (the **controlled entities**) of which the entity is an \*Australian controller at that time; and
    - (ii) that are still \*on issue at that time;
  - (b) all the debt interests issued by the controlled entities:
    - (i) to entities other than the entity or other controlled entities; and
    - (ii) that are still on issue at that time.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-933

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*Worldwide equity*

- (2) An entity's **worldwide equity** at a particular time, means the total of the following amounts:
- (a) all the \*equity capital of the entity as at that time, but worked out disregarding \*equity interests in the entity held at that time by \*Australian controlled foreign entities (the **controlled entities**) of which the entity is an \*Australian controller at that time;
  - (b) all the equity capital of the controlled entities as at that time, but worked out disregarding equity interests in the controlled entities held at that time by:
    - (i) the entity; or
    - (ii) other controlled entities.

**820-933 Statement worldwide debt, statement worldwide equity and statement worldwide assets**

*Statement worldwide debt*

- (1) An entity's **statement worldwide debt** for a period is the amount (see subsection (4)) of liabilities for the entity for the period, reduced (but not below zero) by the sum of the following amounts (see subsection (4)) for the entity for the period:
- (a) provisions;
  - (b) liabilities in relation to distributions to equity participants;
  - (c) trade payables;
  - (d) deferred tax liabilities;
  - (e) liabilities relating to employee benefits;
  - (f) current tax liabilities;
  - (g) deferred revenue;
  - (h) liabilities relating to insurance;
  - (i) any other amount specified in a legislative instrument under subsection (5).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Statement worldwide equity*

- (2) An entity's **statement worldwide equity** for a period means the amount (see subsection (4)) of net assets for the entity for the period.

*Statement worldwide assets*

- (3) An entity's **statement worldwide assets** for a period means the amount (see subsection (4)) of assets for the entity for the period.

*Amounts from audited consolidated financial statements to be used*

- (4) For the purposes of this section:
- (a) an amount for an entity for a period is taken to be that amount as shown in the \*audited consolidated financial statements for the entity for the period; and
  - (b) sections 820-680 and 820-682 do not apply.

*Other amounts*

- (5) The Minister may, by legislative instrument, specify one or more amounts for the purposes of paragraph (1)(i).

**820-935 Meaning of *audited consolidated financial statements***

- (1) **Audited consolidated financial statements** for an entity for a period are:
- (a) the financial statements that meet the requirements in subsection (2) for the entity for the period; or
  - (b) if more than one set of financial statements meet the requirements in subsection (2) for the entity for the period—whichever of those sets of financial statements the entity chooses.
- (2) Financial statements meet the requirements in this subsection for an entity for a period (the **relevant period**) if:
- (a) the statements have been prepared on a consolidated basis in relation to the entity and one or more other entities in

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-935

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- accordance with standards covered by subsection (3) or (4) (the *recognised overseas accounting standards*); and
- (b) one of the entities is a worldwide parent entity mentioned in subsection (6); and
  - (c) the statements show the amounts mentioned in subsections 820-933(1), (2) and (3) (however described) on that consolidated basis and in accordance with those standards; and
  - (d) the statements have been audited (and the auditor's report is unqualified) in accordance with a requirement in the law of:
    - (i) a foreign jurisdiction mentioned in subsection (3) of this section; or
    - (ii) another jurisdiction that has adopted the standards mentioned in subsection (4); and
  - (e) the statements are for the most recent period ending:
    - (i) no later than the end of the relevant period; and
    - (ii) no earlier than 12 months before the start of the relevant period.

*Recognised overseas accounting standards*

- (3) This subsection covers the standards (however described) that apply to the preparation of financial statements and are made, or adopted, by the responsible body in any of the following (a *foreign jurisdiction*):
  - (a) the European Union;
  - (aa) the United Kingdom;
  - (b) the United States of America;
  - (c) Canada;
  - (d) Japan;
  - (e) New Zealand;
  - (f) a jurisdiction specified in an instrument under subsection (5).
- (4) This subsection covers the international financial reporting standards that are made or adopted by the International Accounting Standards Board.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (5) The Minister may, by legislative instrument, specify one or more jurisdictions for the purposes of paragraph (3)(f).

*Worldwide parent entity*

- (6) For the purposes of paragraph (2)(b), an entity in relation to which financial statements have been prepared is a worldwide parent entity if, for the purposes of the standards in accordance with which the statements were prepared, the entity is not controlled by another entity.

## Subdivision 820-K—Zero-capital amount

### Guide to Subdivision 820-K

#### 820-940 What this Subdivision is about

The zero-capital amount represents the value of certain assets that receive special treatment in working out the maximum allowable debt of a financial entity. This Subdivision sets out the rules about the calculation of this amount.

#### Table of sections

820-942 How to work out the zero-capital amount

#### 820-942 How to work out the zero-capital amount

- (1) An entity's ***zero-capital amount*** at a particular time is the result of the method statement in this subsection.

*Method statement*

Step 1. Work out the total value, as at that particular time, of all the assets of the entity that represent \*debt interests that:

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) are of a kind commonly dealt in by entities that carry on a \*business of dealing in securities; and
- (b) the entity has sold under a reciprocal purchase agreement (otherwise known as a repurchase agreement), sell-buyback arrangement or securities loan arrangement; and
- (c) the entity has not yet repurchased under the agreement or arrangement.

Step 2. Add to the result of step 1 the total value, as at that time, of all the \*debt interests issued to the entity to which the following paragraphs apply at that time:

- (a) the debt interests remain \*on issue;
- (b) each of the debt interests is a loan of money for which no fees, charges or other consideration for the purpose of enhancing the credit rating of the issuer of the interest has been paid or is payable to the entity, any of the entity's \*associates or another entity that is a \*foreign entity;
- (c) each of the entities issuing the interests has the required credit rating for the interests concerned in accordance with subsections (4) and (5).

Step 3. Add to the result of step 2 the total value, as at that time, of all the \*debt interests that are assets of the entity (whether they are debt interests issued to the entity or not) and to which the following paragraphs apply at that time:

- (a) the risk weight of each of the debt interests is either 0% or 20% under the \*prudential standards;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the debt interests do not satisfy all of the paragraphs in step 2.

Step 3A. Add to the result of step 3 the total value, as at that time, of all the assets of the entity, to the extent that they:

- (a) consist of rights to the return of assets covered by subsection (2A); and
- (b) are covered by none of steps 1, 2 and 3.

Step 4. Add to the result of step 3A the total value, as at that time, of all the \*securitised assets that the entity has at that time if the entity is a \*securitisation vehicle at that time (see subsections (2) and (3)). The result is the ***zero-capital amount***.

(2A) This subsection covers an asset that:

- (a) the entity provided as security for the performance of its obligations in relation to securities it acquired under a reciprocal purchase agreement (otherwise known as a repurchase agreement), sell-buyback arrangement or securities loan arrangement; and
- (b) does not consist of \*shares.

#### *Securitisation vehicle*

(2) An entity is a ***securitisation vehicle*** if:

- (a) it is an entity established for the purposes of acquiring, funding and holding \*securitised assets (see subsection (3)); and
- (b) it has acquired the securitised assets from another entity (the ***originator***); and
- (c) the acquisition of the securitised assets is wholly funded by the issuing of \*debt interests by the entity; and
- (d) in issuing the debt interests, the entity does not receive any guarantee, security or other form of credit support from any

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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of its \*associate entities, the originator or any associate entity of the originator; and

- (e) the entity has not issued debt interests for any purpose other than for the purpose of funding the acquisition of the securitised assets; and
- (f) there are no debt interests issued to the entity by any of the entity's associate entities, the originator or any associate entity of the originator; and
- (g) any \*arrangements the entity has with any of its associate entities, the originator or any associate entity of the originator are those that would reasonably be expected to have been entered into by parties dealing at \*arm's length with each other.

Note: An entity that does not qualify as a securitisation vehicle may be exempt from the thin capitalisation rules under section 820-39.

*Securitised assets*

- (3) An asset of an entity is a **securitised asset** if:
  - (a) the entity is a \*securitisation vehicle; and
  - (b) the asset consists of:
    - (i) \*debt interests issued by an entity other than the originator in relation to the securitisation vehicle that is mentioned in paragraph (2)(b); or
    - (ii) a lease for the hire of goods that would be a lease covered by paragraph (b) of the definition of **on-lent amount** if a reference to an entity in that definition were a reference to that originator; or
    - (iii) a \*scheme that, apart from the operation of paragraph 974-25(1)(b), would have given rise to a debt interest covered by subparagraph (i); and
  - (c) the asset provides security for the issuing of debt interests that funded the acquisition of the asset by the securitisation vehicle (see paragraph (2)(c)).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

*What is the required credit rating?*

- (4) For the purposes of step 2 of the method statement in subsection (1), the required credit rating for an entity issuing a \*debt interest is:
- (a) if the interest is a \*subordinated debt interest—a long-term foreign currency corporate credit rating of at least A (or equivalent) given to the entity by an internationally recognised rating agency; or
  - (b) if the interest is not a subordinated debt interest—a long-term foreign currency corporate credit rating of at least BBB (or equivalent) given to the entity by an internationally recognised rating agency.

*When must an entity have the required credit rating*

- (5) The entity must have the required credit rating as specified in any of the following paragraphs:
- (a) the entity had the required credit rating for the \*debt interest when the interest was issued;
  - (b) the following subparagraphs apply:
    - (i) the entity did not have any long-term foreign currency corporate credit rating given to it by an internationally recognised rating agency when the debt interest was issued; but
    - (ii) the entity had the required credit rating for that interest at any time during the period of 6 months immediately before the interest was issued;
  - (c) the following subparagraphs apply:
    - (i) when the debt interest was issued, and throughout the period of 6 months immediately before the interest was issued, the entity did not have any long-term foreign currency corporate credit rating given to it by an internationally recognised rating agency; but
    - (ii) the entity has the required credit rating for that interest at any time during the period of 6 months immediately after the interest was issued.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Subdivision 820-KA—Cost-free debt capital and excluded equity interests

### Guide to Subdivision 820-KA

#### 820-945 What this Subdivision is about

This Subdivision sets out the meaning of cost-free debt capital, and excluded equity interest, for the purposes of this Division.

#### Table of sections

820-946 *Cost-free debt capital and excluded equity interest*

#### 820-946 *Cost-free debt capital and excluded equity interest*

- (1) This subsection applies to an entity for a period (the ***relevant period***) that is all or a part of an income year if the entity satisfies all of the following:
- (a) the entity is an \*outward investing entity (non-ADI) or \*inward investing entity (non-ADI) for that period;
  - (b) if the entity is a \*foreign entity—the entity holds any of the following assets throughout that period:
    - (i) assets that are attributable to the entity's \*Australian permanent establishments;
    - (ii) other assets that are held for the purposes of producing the entity's assessable income;
  - (c) neither section 820-35 (\$2 million debt deductions threshold) nor section 820-37 (exemption for entity with 90% Australian assets) prevents Subdivision 820-B, 820-C, 820-D or 820-E from disallowing any \*debt deduction of the entity for the income year;
  - (da) for some or all of that period, the entity does *not* meet the conditions in subsection 820-39(3) (about exemption of certain special purpose entities);
  - (d) the entity is not an \*exempt entity for the income year.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



Note: Paragraph (c) corresponds to the threshold tests for this Division set out in sections 820-35 and 820-37.

- (2) The ***cost-free debt capital*** of the entity at a particular time during the relevant period is the total value of all the ***\*debt interests*** ***\*issued*** by the entity that satisfy all of the following:
- (a) the interests are ***\*on issue*** at that time;
  - (b) none of the interests gives rise to any cost, at any time, that is covered by paragraph 820-40(1)(a);
  - (c) each of the interests is covered by subsection (3) or (4) of this section at that time.
- (2A) An ***\*equity interest*** in the entity is an ***excluded equity interest*** at a particular time during the relevant period if, and only if:
- (a) if subsection (1) does not apply to the holder of the interest for all or part of the relevant period:
    - (i) the entity is an ***\*associate*** of the holder; and
    - (ii) at that time, the interest has been ***\*on issue*** for a period of less than 180 days; or
  - (b) if subsection (1) applies to the holder for all or part of the relevant period:
    - (i) the entity is an associate of the holder; and
    - (ii) at that time, the interest has been on issue for a period of less than 180 days; and
    - (iii) the interest is covered by subsection (3) at that time.
- However, the interest is taken *not* to have been an ***excluded equity interest*** at the time if the total period for which the interest remains on issue is 180 days or more.
- (3) This subsection covers a ***\*debt interest*** or ***\*equity interest*** held by an entity (the ***holder***) at the particular time mentioned in subsection (2) or (2A) if:
- (a) subsection (1) also applies to the holder for a period (the ***overlapped period***) that is, or includes, all or a part of the relevant period; and
  - (b) for the purposes of applying this Division to both the holder and the issuer of the interest (the ***issuer***), and in relation to

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***\****To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 820-950

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only that part of the overlapped period that falls within the relevant period, either or both of the following apply:

- (i) the \*valuation days used to calculate the average value of the holder's assets are different from the valuation days used to calculate the issuer's \*adjusted average debt;
  - (ii) the number of valuation days used to calculate the average value of the holder's assets are different from the number of valuation days used to calculate the issuer's adjusted average debt.
- (4) This subsection covers a \*debt interest held by an entity (the **holder**) at the particular time mentioned in subsection (2) if:
- (a) subsection (1) does not apply to the holder for a period that is, or includes, all or a part of the relevant period; and
  - (b) at that time, the debt interest has been \*on issue for a period of less than 180 days.
- However, if the total period for which the interest remains on issue is 180 days or more, this subsection is taken *not* to have covered the interest at that time.
- (5) For the purposes of subsection (2), take into account the value of a \*debt interest issued by a \*foreign entity only to the extent that the interest is attributable to assets covered by subparagraph (1)(b)(i) or (ii) that are held by the foreign entity throughout the relevant period.

### Subdivision 820-L—Record keeping requirements

#### Guide to Subdivision 820-L

#### 820-950 What this Subdivision is about

This Subdivision sets out special record keeping requirements and related provisions about the following:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (a) an entity that carries on its business at or through its Australian permanent establishments;
- (b) an arm's length debt amount or arm's length capital amount worked out under this Division.

**Table of sections****Records about Australian permanent establishments**

- 820-960 Records about Australian permanent establishments
- 820-962 Records about Australian permanent establishments—exemptions from Australian accounting standards
- 820-965 Review of Commissioner's decision

**Records about arm's length amounts**

- 820-980 Records about arm's length debt amount and arm's length capital amount

**Offences committed by certain entities**

- 820-990 Offences—treatment of partnerships
- 820-995 Offences—treatment of unincorporated companies

**Records about Australian permanent establishments****820-960 Records about Australian permanent establishments**

- (1) If an entity:
  - (a) is an \*inward investor (general), \*inward investor (financial) or \*inward investing entity (ADI), for all or a part of an income year; and
  - (b) carries on its \*business at or through one or more of its \*Australian permanent establishments throughout that year; and
  - (c) has total revenues attributable to those Australian permanent establishments for that year that are at least \$2,000,000;
 the entity must keep for that year the records for which subsection (1A) or (1B) provides.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 820-960

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Note: A person must comply with the requirements in section 262A of the *Income Tax Assessment Act 1936* about the keeping of these records (see subsections (2AA) and (3) of that section).

*Australian accounting standards*

- (1A) If the entity chooses this subsection, it must keep the following records for the \*Australian permanent establishments:
- (a) a statement of financial position (within the meaning of the \*accounting standards);
  - (b) a statement of financial performance (within the meaning of those standards).

The statements must:

- (c) be prepared in accordance with the \*accounting standards (in particular, but not limited to, accounting standards AASB 1001, AASB 1018 and AASB 1040); and
- (d) include all the notes required to accompany them under the standards.

Note: For exemptions, see section 820-962.

*Overseas and international accounting standards*

- (1B) If the entity chooses this subsection, it must keep for the \*Australian permanent establishments the statements (however described) that, under standards covered by subsection (1C) or (1D) (the ***overseas or international accounting standards***), correspond to the statements referred to in subsection (1A). The statements must:
- (a) be prepared in accordance with those standards; and
  - (b) include all the notes required to accompany them under those standards.
- (1C) This subsection covers the standards (however described) that correspond to the \*accounting standards and are made by the responsible body in:
- (a) the United Kingdom of Great Britain and Northern Ireland;
- or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (b) the United States of America; or
  - (c) Canada; or
  - (d) New Zealand; or
  - (e) Japan; or
  - (f) the French Republic; or
  - (g) the Federal Republic of Germany.
- (1D) This subsection covers the international accounting standards made or adopted by the International Accounting Standards Board.

*Requirements for the records under subsection (1A) or (1B)*

- (2) The entity must prepare the records for which subsection (1A) or (1B) provides:
- (a) before the time by which the entity must lodge its \*income tax return for the income year; and
  - (b) as if:
    - (i) the \*Australian permanent establishments were an entity (the **notional entity**) for which those records would be required to be prepared under the \*accounting standards or the overseas or international accounting standards, as appropriate; and
    - (ii) for the purposes of the statement of financial position or the corresponding statement, as appropriate—the assets, liabilities (including \*debt capital) and \*equity capital that are attributable to the Australian permanent establishments for that income year were assets, liabilities and equity of the notional entity for that year; and
    - (iii) for the purposes of the statement of financial performance or the corresponding statement, as appropriate—the revenues and expenses that are attributable to the Australian permanent establishments for that year were the revenues and expenses of the notional entity for that year; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (iv) the \*accounting standards, or the overseas or international accounting standards, as appropriate, referred to income years instead of financial years or the corresponding term in the overseas or international accounting standards.

*Excluding Australian permanent establishments not covered by applicable double tax treaty*

- (6) An entity need not comply with this section for an income year in relation to an \*Australian permanent establishment if:
  - (a) throughout that year, the entity was, for the purposes of a double tax agreement (within the meaning of Part X of the *Income Tax Assessment Act 1936*) in relation to a foreign country, a resident of that foreign country (even if the entity was also an Australian resident or a resident of another foreign country); and
  - (b) throughout the period during that year when the entity was carrying on its \*business at or through that Australian permanent establishment, the Australian permanent establishment was *not* a permanent establishment within the meaning of that double tax agreement.

**820-962 Records about Australian permanent establishments—  
exemptions from Australian accounting standards**

*General exemption*

- (1) The Commissioner may, by legislative instrument, exempt, for the purposes of subsection 820-960(1A), a specified class of entities from the requirement to comply with all or part of the \*accounting standards for one or more income years if the Commissioner is satisfied that it would be unreasonable for the entities in that class be required to so comply.

Note: The Commissioner's power under this subsection does not extend to the overseas or international accounting standards.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Application for specific exemption*

- (2) An entity (the **applicant**) may apply to the Commissioner, in the \*approved form, for an exemption from the requirement to comply with all or part of the \*accounting standards for one or more income years for the purposes of subsection 820-960(1A).
- (3) The Commissioner may grant the exemption in whole or in part if the Commissioner is satisfied that it would be unreasonable for the applicant to be required to so comply.

Note: The Commissioner's power under this subsection does not extend to the overseas or international accounting standards.

- (4) The Commissioner must give the applicant written notice if the Commissioner:
- (a) grants the exemption; or
  - (b) refuses to grant the exemption.
- (5) The Commissioner is taken to have refused to grant the exemption if the Commissioner fails to give the applicant a notice under subsection (4) within 60 days after the application is made.
- (6) A notice under subsection (4) is not a legislative instrument.

**820-965 Review of Commissioner's decision**

A person who is dissatisfied with a decision of the Commissioner under subsection 820-962(3) may object against the decision in the manner set out in Part IVC of the *Taxation Administration Act 1953*.

**Records about arm's length amounts****820-980 Records about arm's length debt amount and arm's length capital amount**

- (1) An entity must keep records under this section for an \*arm's length debt amount or \*arm's length capital amount that the entity worked out for the purposes of this Division.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 820-990

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- (2) The records must contain particulars about the factual assumptions and relevant factors mentioned in section 820-105, 820-215, 820-315 or 820-410 (as appropriate) that have been taken into account in working out that amount.
- (3) The entity must prepare the records before the time by which the entity must lodge its \*income tax return for the income year in relation to all or a part of which the amount is worked out.

Note: A person must comply with the requirements in section 262A of the *Income Tax Assessment Act 1936* about the keeping of these records (see subsections (2AA) and (3) of that section).

## Offences committed by certain entities

### 820-990 Offences—treatment of partnerships

- (1) The provisions set out in the following paragraphs (the **relevant provisions**) apply, in relation to records required to be kept under this Subdivision, to a partnership as if it were a person, but with the modifications set out in this section:
  - (a) sections 820-960, 820-962 and 820-980;
  - (b) section 262A of the *Income Tax Assessment Act 1936*;
  - (c) Part III of the *Taxation Administration Act 1953*.
- (2) If the relevant provisions would otherwise require or permit something to be done by the partnership, the thing may be done by one or more of the partners on behalf of the partnership.
- (3) An obligation that would otherwise be imposed on the partnership by the relevant provisions:
  - (a) is imposed on each partner instead; but
  - (b) may be discharged by any of the partners.
- (4) The partners are jointly and severally liable to pay an amount that would otherwise be payable by the partnership under the relevant provisions.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



- (5) An offence against any of the relevant provisions that would otherwise be committed by the partnership is taken to have been committed by each partner who:
- (a) did the relevant act or made the relevant omission; or
  - (b) aided, abetted, counselled or procured the relevant act or omission; or
  - (c) was in any way knowingly concerned in, or party to, the relevant act or omission (whether directly or indirectly or whether by any act or omission of the partner).
- (6) For the purposes of subsection (5):
- (a) to establish that a partnership engaged in a particular conduct, it is sufficient to show that the conduct was engaged in by a partner:
    - (i) in the ordinary course of the business of the partnership; or
    - (ii) within the scope of the actual or apparent authority of the partner; and
  - (b) to establish that a partnership had a particular state of mind when it engaged in that conduct, it is sufficient to show that the partner had the relevant state of mind.
- (7) For the purposes of the relevant provisions, a change in the composition of a partnership does not affect the continuity of the partnership.

### **820-995 Offences—treatment of unincorporated companies**

- (1) The provisions set out in the following paragraphs (the **relevant provisions**) apply, in relation to records required to be kept under this Subdivision, to an unincorporated company as if it were a person, but with the modifications set out in this section:
- (a) sections 820-960, 820-962 and 820-980;
  - (b) section 262A of the *Income Tax Assessment Act 1936*;
  - (c) Part III of the *Taxation Administration Act 1953*.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (2) If the relevant provisions would otherwise require or permit something to be done by the company, the thing may be done by one or more members of the company's committee of management (the *members*) on behalf of the company.
- (3) An obligation that would otherwise be imposed on the company by the relevant provisions:
  - (a) is imposed on each member instead; but
  - (b) may be discharged by any of the members.
- (4) The members are jointly and severally liable to pay an amount that would otherwise be payable by the company under the relevant provisions.
- (5) An offence against any of the relevant provisions that would otherwise be committed by the company is taken to have been committed by each member who:
  - (a) did the relevant act or made the relevant omission; or
  - (b) aided, abetted, counselled or procured the relevant act or omission; or
  - (c) was in any way knowingly concerned in, or party to, the relevant act or omission (whether directly or indirectly or whether by any act or omission of the member).
- (6) For the purposes of subsection (5), to establish that the company had a particular state of mind when it engaged in a particular conduct, it is sufficient to show that a member had the relevant state of mind.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Division 830—Foreign hybrids

### Table of Subdivisions

	Guide to Division 830
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830-B	Extension of normal partnership provisions to foreign hybrid companies
830-C	Special rules applicable while an entity is a foreign hybrid
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### Guide to Division 830

#### 830-1 What this Division is about

This Division:

- (a) provides for certain entities (called foreign hybrids) that are treated as partnerships for the purposes of foreign income tax, but as companies for the purposes of tax within the meaning of this Act, to be treated as partnerships for the purposes of this Act; and
- (b) applies special rules to the entities in addition to those that normally apply to partnerships.

### Subdivision 830-A—Meaning of “foreign hybrid”

#### Table of sections

830-5	Foreign hybrid
830-10	Foreign hybrid limited partnership
830-15	Foreign hybrid company

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 830-5

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**830-5 Foreign hybrid**

The expression *foreign hybrid* means:

- (a) a \*foreign hybrid limited partnership; or
- (b) a \*foreign hybrid company.

**830-10 Foreign hybrid limited partnership**

- (1) Subject to subsection (2), a \*limited partnership is a *foreign hybrid limited partnership* in relation to an income year if:
  - (a) it was formed in a foreign country; and
  - (b) \*foreign income tax (except \*credit absorption tax or \*unitary tax) is imposed under the law of the foreign country on the partners, not the limited partnership, in respect of the income or profits of the partnership for the income year; and
  - (c) at no time during the income year is the limited partnership, for the purposes of a law of any foreign country that imposes foreign income tax (except credit absorption tax or unitary tax) on entities because they are residents of the foreign country, a resident of that country; and
  - (d) disregarding subsection 94D(5) of the *Income Tax Assessment Act 1936*, at no time during the income year is it an Australian resident; and
  - (e) disregarding that subsection, in relation to the same income year of another taxpayer:
    - (i) the limited partnership is a \*CFC at the end of a \*statutory accounting period that ends in the income year; and
    - (ii) at the end of the statutory accounting period, the taxpayer is an \*attributable taxpayer in relation to the CFC with an \*attribution percentage greater than nil.
- (2) If a partner is not an \*attributable taxpayer in relation to a \*limited partnership, then, for the purposes of applying the *Income Tax Assessment Act 1936* and this Act in relation to the partner's interest in the limited partnership, the limited partnership is a

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

***foreign hybrid limited partnership*** in relation to an income year for the partner if, and only if, the partner:

- (a) has made an election under former subsection 485AA(1) of the *Income Tax Assessment Act 1936*; or
  - (b) makes an election under this paragraph; in relation to the partner's interest in the partnership.
- (3) For the purposes of subsection (2), the limited partnership is a ***foreign hybrid limited partnership*** in relation to any income year during which an election referred to in paragraph (2)(a) or (2)(b) is in force.
- (4) An election can only be made under paragraph (2)(b) if:
- (a) disregarding subsection 94D(6) of the *Income Tax Assessment Act 1936*:
    - (i) at the end of the income year in which the election is made, the partner has an interest in a FIF (within the meaning of former Part XI of that Act) that is a \*corporate limited partnership; and
    - (ii) the interest consists of a \*share in the FIF; and
  - (b) the limited partnership satisfies paragraphs (1)(a) to (d) in relation to the income year in which the election is made.
- (5) An election under paragraph (2)(b) must be made:
- (a) on or before the day on which the partner lodges the partner's income tax return for the income year; or
  - (b) within a further time allowed by the Commissioner.
- (6) The election:
- (a) is in force during the income year and all later income years; and
  - (b) is irrevocable.

### **830-15 Foreign hybrid company**

- (1) Subject to subsection (5), a company is a ***foreign hybrid company*** in relation to an income year if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) at all times during the income year when the company is in existence, the partnership treatment requirements for the income year in subsection (2) or (3) are satisfied; and
- (b) at no time during the income year is the company, for the purposes of a law of any foreign country that imposes \*foreign income tax (except \*credit absorption tax or \*unitary tax) on entities because they are residents of the foreign country, a resident of that country; and
- (c) at no time during the income year is the company an Australian resident; and
- (d) disregarding this Division, in relation to the same income year of another taxpayer:
  - (i) the company is a \*CFC at the end of a \*statutory accounting period that ends in the income year; and
  - (ii) at the end of the statutory accounting period, the taxpayer is an \*attributable taxpayer in relation to the CFC with an \*attribution percentage greater than nil.

*Partnership treatment requirements specific to USA*

- (2) For the purposes of paragraph (1)(a), the partnership treatment requirements are satisfied if:
  - (a) the company was formed in the United States of America; and
  - (b) for the purposes of the law of that country relating to \*foreign income tax (except \*credit absorption tax or \*unitary tax) imposed by that country, the company is a limited liability company that:
    - (i) is treated as a partnership; or
    - (ii) is an eligible entity that is disregarded as an entity separate from its owner.

*Partnership treatment requirements relating to any foreign country*

- (3) For the purposes of paragraph (1)(a), the partnership treatment requirements are also satisfied if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) the company was formed in a foreign country (which may be the United States of America); and
  - (b) for the purposes of the law of that country relating to \*foreign income tax (except \*credit absorption tax or \*unitary tax) imposed by that country, the company is treated as a partnership; and
  - (c) regulations are in force setting out requirements to be satisfied by a company in relation to the income year for the purposes of this paragraph, and the company satisfies those requirements.
- (4) Regulations for the purposes of paragraph (3)(c) cannot set out requirements in relation to any income year before the one in which the regulations are made.
- (5) If a shareholder is not an \*attributable taxpayer in relation to a company, then, for the purposes of applying the *Income Tax Assessment Act 1936* and this Act in relation to the shareholder's \*share or shares in the company, the company is a **foreign hybrid company** in relation to an income year for the shareholder if, and only if, the shareholder:
  - (a) has made an election under former subsection 485AA(2) of the *Income Tax Assessment Act 1936*; or
  - (b) makes an election under this paragraph;in relation to the shareholder's share or shares in the company.
- (6) For the purposes of subsection (5), the company is a **foreign hybrid company** in relation to any income year during which the election referred to in paragraph (5)(a) or (5)(b) is in force.
- (7) An election can only be made under paragraph (5)(b) if:
  - (a) in relation to the income year in which the election is made, the company:
    - (i) is a FIF (within the meaning of former Part XI of the *Income Tax Assessment Act 1936*); and
    - (ii) satisfies paragraphs (1)(a) to (c); and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) at the end of the income year in which the election is made, the shareholder's interest in the FIF consists of one or more \*shares in the FIF.
- (8) An election under paragraph (5)(b) must be made:
  - (a) on or before the day on which the shareholder lodges the shareholder's income tax return for the income year; or
  - (b) within a further time allowed by the Commissioner.
- (9) The election:
  - (a) is in force during the income year and all later income years; and
  - (b) is irrevocable.

**Subdivision 830-B—Extension of normal partnership provisions to foreign hybrid companies**

**Note:** The normal partnership provisions will apply of their own force to foreign hybrids that are foreign hybrid limited partnerships.

**Table of sections**

830-20	Treatment of company as a partnership
830-25	Partners are the shareholders in the company
830-30	Individual interest of a partner in net income etc. equals percentage of notional distribution of company's profits
830-35	Partner's interest in assets
830-40	Control and disposal of share in partnership income

**830-20 Treatment of company as a partnership**

If a company is a \*foreign hybrid company in relation to an income year, the \*foreign hybrid tax provisions apply as if the company were a partnership, and for that purpose the following provisions of this Subdivision have effect.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**830-25 Partners are the shareholders in the company**

The partners in the partnership are the \*shareholders in the company.

**830-30 Individual interest of a partner in net income etc. equals percentage of notional distribution of company's profits**

The individual interest of a partner in the \*net income or \*partnership loss of the partnership of the income year is equal to the percentage that, if the profits of the company for the income year were distributed at the end of the income year to its \*shareholders:

- (a) if paragraph (b) does not apply—as dividends; or
- (b) if the company's \*constitution or other rules provide for the distribution of profits other than as dividends—in accordance with the constitution or those rules;

the partner, as a shareholder, could reasonably be expected to receive of the total distribution.

**830-35 Partner's interest in assets**

- (1) The interest that each partner has in the assets of the partnership, under the partnership agreement, is equal to the percentage in subsection (2).
- (2) The percentage is the percentage that, if the capital of the company were distributed to its \*shareholders on a winding-up of the company at the end of the income year, the partner, as a shareholder, could reasonably be expected to receive of the total distribution.

**830-40 Control and disposal of share in partnership income**

- (1) This section applies for the purposes of determining under section 94 of the *Income Tax Assessment Act 1936* whether the partnership is so constituted or controlled, or its operations are so conducted, that a partner does not have the real and effective

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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control and disposal of the partner's share, or a part of the partner's share, in the \*net income of the partnership of an income year.

- (2) The reference to the partner's share, or a part of the partner's share, in the \*net income is a reference to any rights that the \*shareholder has under the \*constitution or other rules of the company that were taken into account under section 830-30 in working out the individual interest of the partner in the partnership's net income or \*partnership loss of the income year.

**Subdivision 830-C—Special rules applicable while an entity is a foreign hybrid**

Note: In the case of a foreign hybrid company, references in this Subdivision that relate to partnerships are to be read subject to Subdivision 830-B. For example, a reference to a partner will be a reference to a shareholder in the company who is treated by Subdivision 830-B as a partner.

**Table of sections**

830-45	Partner's revenue and net capital losses from foreign hybrid not to exceed partner's loss exposure amount
830-50	Deduction etc. where partner's foreign hybrid revenue loss amount and foreign hybrid net capital loss amount are less than partner's loss exposure amount
830-55	Meaning of <i>foreign hybrid net capital loss amount</i>
830-60	Meaning of <i>loss exposure amount</i>
830-65	Meaning of <i>outstanding foreign hybrid revenue loss amount</i>
830-70	Meaning of <i>outstanding foreign hybrid net capital loss amount</i>
830-75	Extended meaning of <i>subject to foreign tax</i>

**830-45 Partner's revenue and net capital losses from foreign hybrid not to exceed partner's loss exposure amount**

- (1) This section applies to a \*limited partner in a \*foreign hybrid in relation to an income year if the sum of the following amounts:
- (a) any amount (a *foreign hybrid revenue loss amount*) allowable to the partner as a deduction under subsection 92(2) of the *Income Tax Assessment Act 1936* in

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

respect of a \*partnership loss of the foreign hybrid for the income year;

- (b) any \*foreign hybrid net capital loss amount of the partner in respect of the foreign hybrid for the income year; exceeds the partner's \*loss exposure amount for the income year.

*Reduction in foreign hybrid revenue loss amount or foreign hybrid net capital loss amount*

- (2) If this section applies, the amount mentioned in paragraph (1)(a) or (b), or each of the amounts mentioned in those paragraphs, is reduced so that in total they equal the partner's \*loss exposure amount. The partner must choose how much of the reduction is applied to each of the amounts.

*Effect of reducing foreign hybrid net capital loss amount*

- (3) If the partner's \*foreign hybrid net capital loss amount in respect of the \*foreign hybrid for the income year is reduced under subsection (2), the partner's \*net capital gain or \*net capital loss for the income year is worked out by assuming that the \*capital gains and \*capital losses taken into account in working out the partner's foreign hybrid net capital loss amount were instead a capital loss equal to the foreign hybrid net capital loss amount after the reduction.

### **830-50 Deduction etc. where partner's foreign hybrid revenue loss amount and foreign hybrid net capital loss amount are less than partner's loss exposure amount**

- (1) This section applies if:
- (a) the sum of a partner's \*foreign hybrid revenue loss amount and \*foreign hybrid net capital loss amount for a \*foreign hybrid for an income year does not exceed the partner's \*loss exposure amount for the foreign hybrid for the income year (the difference being the partner's *available loss exposure amount*); and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the partner has one or more \*outstanding foreign hybrid revenue loss amounts or one or more \*outstanding foreign hybrid net capital loss amounts, or both, in respect of the foreign hybrid for the income year.

*Where sum of outstanding foreign hybrid revenue loss amounts and outstanding foreign hybrid net capital loss amounts does not exceed available loss exposure amount*

- (2) If the sum of the \*outstanding foreign hybrid revenue loss amounts and the \*outstanding foreign hybrid net capital loss amounts does not exceed the \*available loss exposure amount:
  - (a) a deduction is allowable to the partner for the income year equal to the sum of the outstanding foreign hybrid revenue loss amounts; and
  - (b) the partner makes a \*capital loss for the income year under section 104-270 equal to the sum of the outstanding foreign hybrid net capital loss amounts.

*Where sum of outstanding foreign hybrid revenue loss amounts and outstanding foreign hybrid net capital loss amounts exceeds available loss exposure amount*

- (3) If the sum of the \*outstanding foreign hybrid revenue loss amounts and the \*outstanding foreign hybrid net capital loss amounts exceeds the \*available loss exposure amount, then either or both of the following apply:
  - (a) a deduction is allowable to the partner for the income year equal to some or all of the outstanding foreign hybrid revenue loss amounts;
  - (b) the partner makes a \*capital loss under section 104-270 equal to some or all of the outstanding foreign hybrid net capital loss amounts;such that the sum of the deduction and the capital loss equals the available loss exposure amount.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Partner to choose how to apply subsection (3)*

- (4) The partner must choose:
- (a) which of paragraphs (3)(a) and (b) is to apply or whether both are to apply; and
  - (b) the amount of the deduction or \*capital loss, or the amounts of both; and
  - (c) the particular outstanding foreign hybrid revenue loss amounts or outstanding foreign hybrid net capital loss amounts, or both, to which they relate.

**830-55 Meaning of *foreign hybrid net capital loss amount***

If:

- (a) the sum of a partner's \*capital losses from \*CGT events happening during an income year in relation to a \*foreign hybrid or \*CGT assets of a foreign hybrid;

exceeds:

- (b) the sum of the partner's \*capital gains from CGT events happening during the income year in relation to the foreign hybrid or CGT assets of the foreign hybrid;

the partner has a ***foreign hybrid net capital loss amount*** in respect of the foreign hybrid for the income year equal to the excess.

**830-60 Meaning of *loss exposure amount***

- (1) The ***loss exposure amount*** of a partner in a \*foreign hybrid for an income year is worked out as follows:

*Method statement*

Step 1. Work out the sum of the amounts or \*market values of the contributions made by the partner to the \*foreign hybrid that, as at the end of the income year:

- (a) have not been repaid or returned to the partner; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) have been contributed for at least 180 days, or are intended by the partner to remain contributed for at least 180 days.

Step 2. Subtract the sum of the amounts of:

- (a) all \*limited recourse debts owed by the partner at the end of the income year, to the extent that the \*borrowings concerned were for the purpose of enabling the partner to make contributions to the \*foreign hybrid and the debts were secured by the partner's interest in the foreign hybrid; and
- (b) all the partner's \*foreign hybrid revenue loss amounts in respect of the foreign hybrid for previous income years, after any reduction under subsection 830-45(2); and
- (c) all the partner's \*foreign hybrid net capital loss amounts in relation to the partnership for previous income years, after any reduction under subsection 830-45(2); and
- (d) all deductions allowed to the partner under subsection 830-50(2) or (3) in respect of the foreign hybrid for previous income years; and
- (e) all \*capital losses that, as a result of subsection 830-50(2) or (3), the partner made in respect of \*CGT event K12 in respect of the foreign hybrid for previous income years.

*Contribution in case of foreign hybrid company*

- (2) For the purposes of step 1 in the method statement in subsection (1), if:
  - (a) the \*foreign hybrid is a \*foreign hybrid company; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the partner \*acquired its \*shares in the company from another shareholder; and
  - (c) the payment or other consideration for the acquisition of the shares did not constitute the making of a contribution by the partner to the foreign hybrid;
- the payment or other consideration is taken:
- (d) to be a contribution by the partner to the foreign hybrid; and
  - (e) to be so contributed for as long as the partner holds the shares; and
  - (f) to have been repaid to the partner to the extent of any payment that:
    - (i) the foreign hybrid makes to the partner in respect of the share; and
    - (ii) the foreign hybrid describes as a return of capital; and
    - (iii) is attributable to the period during which the partner has held the shares.

**830-65 Meaning of *outstanding foreign hybrid revenue loss amount***

- (1) This section applies if a \*foreign hybrid revenue loss amount of a partner in a \*foreign hybrid in relation to an income year (the ***reduction year***) is reduced under subsection 830-45(2).
- (2) The partner has, for each later income year, an ***outstanding foreign hybrid revenue loss amount*** equal to the amount of the reduction, less the sum of any deductions allowable to the partner under subsection 830-50(2) or (3) in respect of the outstanding foreign hybrid revenue loss amount for income years between the reduction year and the later income year.

*Outstanding foreign hybrid revenue loss amount not to form part of tax loss*

- (3) To avoid doubt, a partner's \*outstanding foreign hybrid revenue loss amount for an income year cannot form part of a \*tax loss for the purposes of Division 36 or 160.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**830-70 Meaning of *outstanding foreign hybrid net capital loss amount***

- (1) This section applies if a \*foreign hybrid net capital loss amount of a partner in a \*foreign hybrid in relation to an income year (the ***reduction year***) is reduced under subsection 830-45(2).
- (2) The partner has, for each later income year, an ***outstanding foreign hybrid net capital loss amount*** equal to the amount of the reduction, less the sum of any \*capital losses that, as a result of subsection 830-50(2) or (3), the partner makes in respect of \*CGT event K12 in respect of the outstanding foreign hybrid net capital loss amount for income years between the reduction year and the later income year.

**830-75 Extended meaning of *subject to foreign tax***

*Where entity becomes a partner*

- (1) If:
  - (a) an entity becomes a partner (the ***first partner***) in a \*foreign hybrid in relation to an income year; and
  - (b) a gain or profit of a capital nature accrues to another partner as a result of the disposal of the whole or part of that other partner's interest in an asset of the foreign hybrid that happens when the first partner becomes a partner; and
  - (c) apart from this subsection, the gain or profit is not \*subject to foreign tax in a \*listed country in any \*tax accounting period; and
  - (d) if the foreign hybrid had disposed of the whole or an equivalent part of the asset at the time of the disposal of the whole or the part of the interest, any gain or profit of a capital nature that accrued to the foreign hybrid in respect of the disposal would have been subject to foreign tax in a listed country in a tax accounting period;

then, for the purposes of Part X of the *Income Tax Assessment Act 1936*, the gain or profit mentioned in paragraph (b) is taken to be

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



subject to foreign tax in the listed country, and in the tax accounting period, mentioned in paragraph (d).

*Where partner increases its interest*

(2) If:

- (a) an entity is a partner (the **first partner**) that increases its interest in a \*foreign hybrid in relation to an income year; and
- (b) a gain or profit of a capital nature accrues to another partner as a result of the disposal of the whole or part of that other partner's interest in an asset of the foreign hybrid that happens when the first partner increases its interest in the foreign hybrid; and
- (c) apart from this subsection, the gain or profit is not \*subject to foreign tax in a \*listed country in any \*tax accounting period; and
- (d) if the foreign hybrid had disposed of the whole or an equivalent part of the asset at the time of the disposal of the whole or the part of the interest, any gain or profit of a capital nature that accrued to the foreign hybrid in respect of the disposal would have been subject to foreign tax in a listed country in a tax accounting period;

then, for the purposes of Part X of the *Income Tax Assessment Act 1936*, the gain or profit mentioned in paragraph (b) is taken to be subject to foreign tax in the listed country, and in the tax accounting period, mentioned in paragraph (d).

*Where entity ceases to be a partner*

(3) If:

- (a) an entity ceases to be a partner in a \*foreign hybrid in relation to an income year; and
- (b) a gain or profit of a capital nature accrues to the entity as a result of the disposal of its interest in an asset of the foreign hybrid that happens when the entity ceases to be a partner; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (c) apart from this subsection, the gain or profit is not \*subject to foreign tax in a \*listed country in any \*tax accounting period; and
  - (d) any gain or profit of a capital nature that accrues to the entity as a result of the disposal of its interest in the foreign hybrid that happens when the entity ceases to be a partner is subject to foreign tax in a listed country in a tax accounting period;
- then, for the purposes of Part X of the *Income Tax Assessment Act 1936*, the gain or profit mentioned in paragraph (b) is taken to be subject to foreign tax in the listed country, and in the tax accounting period, mentioned in paragraph (d).

*Where partner disposes of part of its interest*

- (4) If:
- (a) an entity is a partner that disposes of part of its interest in a \*foreign hybrid in relation to an income year; and
  - (b) a gain or profit of a capital nature accrues to the entity as a result of the disposal of part of its interest in an asset of the foreign hybrid that happens when the entity disposes of the part of its interest in the foreign hybrid; and
  - (c) apart from this subsection, the gain or profit is not \*subject to foreign tax in a \*listed country in any \*tax accounting period; and
  - (d) any gain or profit of a capital nature that accrues to the entity as a result of the disposal of the part of its interest in the foreign hybrid is subject to foreign tax in a listed country in a tax accounting period;
- then, for the purposes of Part X of the *Income Tax Assessment Act 1936*, the gain or profit mentioned in paragraph (b) is taken to be subject to foreign tax in the listed country, and in the tax accounting period, mentioned in paragraph (d).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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### **Subdivision 830-D—Special rules applicable when an entity becomes or ceases to be a foreign hybrid**

**Note:** In the case of a foreign hybrid company, references in this Subdivision that relate to partnerships are to be read subject to Subdivision 830-B. For example, a reference to a partner will be a reference to a shareholder in the company who is treated by Subdivision 830-B as a partner.

#### **Table of sections**

830-80	Setting the tax cost of partners' interests in the assets of an entity that becomes a foreign hybrid
830-85	Setting the tax cost of assets of an entity when it ceases to be a foreign hybrid
830-90	What the expression <i>tax cost is set</i> means
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830-100	What the expression <i>tax cost</i> means
830-105	What the expression <i>asset-based income tax regime</i> means
830-110	No disposal of assets etc. on entity becoming or ceasing to be a foreign hybrid
830-115	Tax losses cannot be transferred to a foreign hybrid
830-120	End of CFC's last statutory accounting period
830-125	How long interest in asset, or asset, held

### **830-80 Setting the tax cost of partners' interests in the assets of an entity that becomes a foreign hybrid**

- (1) This section applies if:
  - (a) an entity is a \*foreign hybrid in relation to an income year (the *hybrid year*); and
  - (b) the entity was in existence at the end of the preceding income year (which may be the income year before this Division first applies to the entity); and
  - (c) the entity was not a foreign hybrid in relation to that preceding income year.
- (2) For the purposes of applying an \*asset-based income tax regime for the hybrid year and each later income year in relation to which the entity continues to be a foreign hybrid, the \*tax cost is set at the

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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start of the hybrid year, for each asset of the \*foreign hybrid in which each partner has an interest at that time.

**830-85 Setting the tax cost of assets of an entity when it ceases to be a foreign hybrid**

- (1) This section applies if:
  - (a) an entity is a \*foreign hybrid in relation to an income year; and
  - (b) the entity is in existence at the start of the next income year; and
  - (c) the entity is not a foreign hybrid in relation to that income year (the *post-hybrid year*).
- (2) For the purposes of applying an \*asset-based income tax regime for the post-hybrid year and each later income year in relation to which the entity continues not to be a foreign hybrid, the \*tax cost is set at the start of the post-hybrid year, for each asset of the entity at that time.

**830-90 What the expression *tax cost is set* means**

The following table explains what the expression *tax cost is set* at the start of the hybrid year or the post-hybrid year means, in relation to an asset in which a partner has an interest or in relation to an asset of the entity, for the purposes of each \*asset-based income tax regime:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 830-90

<b>Tax cost is set</b>		
<b>Item</b>	<b>If the following asset-based income tax regime is to apply:</b>	<b>The expression means that:</b>
1	Subdivisions 40-A to 40-D, sections 40-425 to 40-445 and Subdivision 328-D	the *adjustable value of the interest or the asset at the start of the hybrid year or the post-hybrid year is varied so that it equals the partner's *tax cost setting amount for the interest, or the entity's tax cost setting amount for the asset, at that time in relation to the *asset-based income tax regime
2	Division 70	the value of the interest or the asset at the start of the hybrid year or the post-hybrid year under Division 70 is varied so that it equals the partner's *tax cost setting amount for the interest, or the entity's tax cost setting amount for the asset, at that time in relation to the *asset-based income tax regime
3	Part 3-1 or 3-3	the *cost base or *reduced cost base of the interest or the asset at the start of the hybrid year or the post-hybrid year is varied so that it equals the partner's *tax cost setting amount for the interest, or the entity's tax cost setting amount for the asset, at that time in relation to the *asset-based income tax regime

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 830-95

Tax cost is set		
Item	If the following asset-based income tax regime is to apply:	The expression means that:
4	Division 16E of Part III of the <i>Income Tax Assessment Act 1936</i>	the Division applies as if the interest or the asset were *acquired by the partner or the entity at the start of the hybrid year or the post-hybrid year for a payment equal to the partner's *tax cost setting amount for the interest, or the entity's tax cost setting amount for the asset, at that time in relation to the *asset-based income tax regime
5	Any other provision of this Act or the <i>Income Tax Assessment Act 1936</i>	the cost of the interest or asset at the start of the hybrid year or the post-hybrid year is varied so that it equals the partner's *tax cost setting amount for the interest, or the entity's tax cost setting amount for the asset, at that time in relation to the *asset-based income tax regime

**830-95 What the expression *tax cost setting amount* means**

- (1) A partner's ***tax cost setting amount*** for an interest of the partner in an asset at the start of the hybrid year, in relation to an \*asset-based income tax regime, is worked out as follows:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Method statement*

- Step 1. Work out what would have been the entity's \*tax cost of the asset for the purposes of applying the \*asset-based income tax regime as at the start of the hybrid year if it were not a \*foreign hybrid in relation to the hybrid year.
- Step 2. Multiply the result of step 1 by:
- (a) if the entity is a \*foreign hybrid company in relation to the hybrid year—the percentage applicable to the partner under subsection 830-35(2); or
  - (b) if the entity is a \*foreign hybrid limited partnership in relation to the hybrid year—the individual interest of the partner in the asset, expressed as a percentage of the interests of all of the partners in the asset.
- Step 3. If the partner paid a premium in respect of the \*acquisition of its interest in the asset (see subsection (2)), add the amount of the premium to the result of step 2. If the partner received a discount in respect of the acquisition (see subsection (2)), subtract the amount of the discount from the result of step 2, but not to the extent that this would result in a negative amount.

The result of step 3 is the partner's ***tax cost setting amount*** in respect of the asset.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 830-95

- (2) Work out whether the partner paid a premium or received a discount for its interest in the asset using the following method statement:

*Method Statement*

- Step 1. Add up all the amounts paid by the partner before the start of the hybrid year for its \*shares in the entity (if the entity was a company), or for its interests in the assets of the entity and in the entity (if the entity was a \*limited partnership), that it held at the start of the hybrid year, and subtract all amounts received by the partner in respect of those shares or interests by way of reduction in capital of the entity.
- Step 2. Work out the amount that, if the capital of the entity had been distributed to its \*shareholders on a winding-up or to its partners on a dissolution, at the end of the income year before the hybrid year, the partner could reasonably be expected to have received of the total distribution.
- Step 3. If the result of step 1 exceeds the result of step 2, the partner paid a premium for its interest in the asset. If the result of step 2 exceeds the result of step 1, the partner received a discount for its interest in the asset.
- Step 4. Work out the amount of the premium or discount using the formula:

$$\frac{\text{Result of step 1 in the method statement in subsection (1)}}{\text{Sum of results of step 1 in the method statement in subsection (1) for the partner for all of the *foreign hybrids assets in relation to the *asset-based income tax regime}} \times \text{Excess mentioned in step 3 in the method statement in this subsection}$$

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



- (3) The entity's ***tax cost setting amount*** for an asset at the start of the post-hybrid year in relation to an \*asset-based income tax regime is equal to the sum of what the partners' \*tax costs for their interests in the asset would be at that time for the purpose of applying the asset-based income tax regime if the entity had continued to be a \*foreign hybrid in relation to that income year.

### 830-100 What the expression ***tax cost*** means

The ***tax cost*** of a partner's interest in an asset or of an asset of the entity for the purposes of applying an \*asset-based income tax regime at the start of the post-hybrid year or the hybrid year is worked out using the following table:

<b>Tax cost of an asset</b>		
<b>Item</b>	<b>If the asset-based income tax regime is:</b>	<b>the tax cost of the interest or the asset is:</b>
1	Subdivisions 40-A to 40-D, sections 40-425 to 40-445 and Subdivision 328-D	the *adjustable value of the interest or the asset at the start of the post-hybrid year or the hybrid year
2	Division 70	the value of the interest or the asset at the start of the post-hybrid year or the hybrid year under Division 70
3	Part 3-1 or 3-3	the *cost base or *reduced cost base of the interest or the asset at the start of the post-hybrid year or the hybrid year

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 830-105

Tax cost of an asset		
Item	If the asset-based income tax regime is:	the tax cost of the interest or the asset is:
4	Division 16E of Part III of the <i>Income Tax Assessment Act 1936</i>	the amount that the partner or entity would need to receive if it were to dispose of the interest or asset at the start of the post-hybrid year or the hybrid year without an amount being assessable income of, or deductible to, the partner or entity under section 159GS of the <i>Income Tax Assessment Act 1936</i>
5	Any other provision of this Act or the <i>Income Tax Assessment Act 1936</i>	the cost of the interest or the asset at the start of the post-hybrid year or the hybrid year

**830-105 What the expression *asset-based income tax regime* means**

The provisions listed in the first column in relation to each item in the table in section 830-100 are an *asset-based income tax regime*.

**830-110 No disposal of assets etc. on entity becoming or ceasing to be a foreign hybrid**

To avoid doubt, the fact that an entity becomes or ceases to be a \*foreign hybrid in relation to an income year does not cause:

- (a) a \*CGT event to happen to any \*CGT asset consisting of:
  - (i) any \*share or interest in the entity; or
  - (ii) any interest in an asset of the entity; or
- (b) a disposal or any other event to happen to any other asset consisting of such a share or interest.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**830-115 Tax losses cannot be transferred to a foreign hybrid**

- (1) If an entity is a \*foreign hybrid in relation to an income year, it cannot deduct in that income year a \*tax loss for a \*loss year in relation to which it was not a foreign hybrid.

*Former foreign hybrid can deduct tax losses for income years before it became a foreign hybrid*

- (2) This section does not prevent an entity that:
- (a) is not a \*foreign hybrid in relation to an income year (the ***post-hybrid year***); and
  - (b) was a foreign hybrid in relation to a previous income year; and
  - (c) was not a foreign hybrid in relation to an income year (the ***pre-hybrid year***) before the previous year;
- from deducting, in the post-hybrid year, a \*tax loss for the pre-hybrid year.

**830-120 End of CFC's last statutory accounting period**

If:

- (a) a taxpayer is a partner in an entity that becomes a \*foreign hybrid in relation to an income year; and
- (b) the entity was a \*CFC at the end of the taxpayer's preceding income year; and
- (c) the last \*statutory accounting period of the CFC did not end at the end of the taxpayer's preceding income year; and
- (d) if it had so ended, the taxpayer would have been an \*attributable taxpayer in relation to the CFC;

for the purposes of working out the \*attributable income of the CFC for the taxpayer in respect of the last statutory accounting period of the CFC, that statutory accounting period ends at the end of the taxpayer's preceding income year.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 830-125

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**830-125 How long interest in asset, or asset, held**

*Partner's interest in asset when entity becomes a foreign hybrid*

- (1) If an entity becomes a \*foreign hybrid company in relation to an income year, the interest that a partner has in an asset as mentioned in section 830-35 is taken to have been held by the partner (except for the purposes of having the \*tax cost of the interest set) from the later of the following times:
- (a) when the entity \*acquired the asset;
  - (b) when the partner acquired its \*shares in the entity.

*Entity's asset when it ceases to be a foreign hybrid company*

- (2) If:
- (a) an entity is not a \*foreign hybrid company in relation to an income year (the **post-hybrid year**); and
  - (b) the entity was a \*foreign hybrid company in relation to the preceding income year; and
  - (c) during:
    - (i) that preceding income year; or
    - (ii) any earlier income year in relation to which the entity was also a foreign hybrid;but not at the start of the first income year in relation to which the entity was a foreign hybrid company, the partners in the foreign hybrid company \*acquired an interest in an asset that is an asset of the entity at the start of the post-hybrid year;
- the asset is taken to have been held by the entity (except for the purposes of having the \*tax cost of the asset set) from the time the partners acquired their interests in the asset.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Division 832—Hybrid mismatch rules

### Table of Subdivisions

	Guide to Division 832
832-A	Preliminary
832-B	Concepts relating to mismatches
832-C	Hybrid financial instrument mismatch
832-D	Hybrid payer mismatch
832-E	Reverse hybrid mismatch
832-F	Branch hybrid mismatch
832-G	Deducting hybrid mismatch
832-H	Imported hybrid mismatch
832-I	Dual inclusion income
832-J	Integrity rule
832-K	Modifications for Division 230 (about taxation of financial arrangements)

### Guide to Division 832

#### 832-1 What this Division is about

A “hybrid mismatch” arises if double non-taxation results from the exploitation of differences in the tax treatment of an entity or financial instrument under the laws of 2 or more countries.

There is double non-taxation if a deductible payment is not included in a tax base (this is called a deduction/non-inclusion mismatch), or if a payment gives rise to 2 deductions (this is called a deduction/deduction mismatch). Disallowing a deduction, or including an amount in assessable income, “neutralises” this tax advantage.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-5

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**Subdivision 832-A—Preliminary**

**Guide to Subdivision 832-A**

**832-5 What this Subdivision is about**

This Subdivision sets out some general rules that apply to the provisions of this Division.

**Table of sections**

**Operative provisions**

832-10	Entitlement to receive payment
832-15	Entitlement to receive non-cash benefits
832-20	Losses that arise from payments or parts of payments
832-25	Recipients and payers of a payment
832-30	How this Division applies to entities
832-35	Single entity rule otherwise not disregarded
832-40	Schemes outside Australia
832-45	Relationship between this Division and other charging provisions in this Act
832-50	Relationship between this Division and Division 820
832-55	Division does not affect foreign residence rules
832-60	Valuation of trading stock affected by hybrid mismatch rules

**Operative provisions**

**832-10 Entitlement to receive payment**

This Division applies as if an entity (the *payer*) had made a payment to another entity (the *recipient*) if the recipient is entitled to receive the payment from the payer, even if the payment is not required to be made until a later time.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**832-15 Entitlement to receive non-cash benefits**

This Division applies as if an entity (the *payer*) had made a payment to another entity (the *recipient*) if the recipient received a \*non-cash benefit from the payer.

**832-20 Losses that arise from payments or parts of payments**

- (1) This section applies if:
- (a) a loss gives rise to:
    - (i) a deduction for an entity (the *payer*) for an income year; or
    - (ii) a \*foreign income tax deduction for an entity (also the *payer*) for a \*foreign tax period; and
  - (b) in working out the amount of the loss:
    - (i) all or a part of a payment made, or to be made, to one or more other entities is taken into account; or
    - (ii) 2 or more payments made, or to be made, to one or more other entities are taken into account.

Note: This section also applies to losses from Division 230 financial arrangements: see section 832-780.

*Payments made to only one entity*

- (2) If, in working out the amount of the loss, a payment or payments made to only one entity (the *recipient*) are taken into account, this Division applies as if:
- (a) at the end of the income year or \*foreign tax period identified in paragraph (1)(a), the payer made a payment to the recipient; and
  - (b) the amount of the payment was equal to the amount of the deduction or \*foreign income tax deduction; and
  - (c) the payment gave rise to the deduction or foreign income tax deduction.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-25

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*Payments made to 2 or more entities*

- (3) If, in working out the amount of the loss, a payment or payments made to 2 or more entities (each of which is a **recipient**) are taken into account, this Division applies as if:
- (a) at the end of the income year or \*foreign tax period identified in paragraph (1)(a), the payer made a payment to each recipient; and
  - (b) the amount of each payment was equal to so much of the amount of the deduction or \*foreign income tax deduction as is reasonable having regard to the amounts of the payments actually made to the recipients; and
  - (c) the payment gave rise to a deduction or foreign income tax deduction equal to the amount of the payment.

*Working out whether the payment has been subject to tax*

- (4) In working out for the purposes of this Division the extent to which a payment that is taken by this section to have been made is \*subject to Australian income tax or \*subject to foreign income tax, regard is to be had to the actual payments made to the recipient.

**832-25 Recipients and payers of a payment**

- (1) To the extent this Division applies to a payment only because of section 832-10 or 832-15 (a **payment provision**), it applies as if:
- (a) the entity that made the payment were the entity identified in the payment provision as the payer; and
  - (b) the recipient of the payment were the entity identified in the payment provision as the recipient.
- (2) If a payment would, apart from this subsection, be made to 2 or more recipients, then this Division applies as if each part of the payment made to each such recipient were a separate payment.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**832-30 How this Division applies to entities***Identifying payments between entities etc.*

- (1) A number of provisions in this Division refer to an entity making a payment to another entity. In determining for the purposes of this Division whether an entity makes or receives a payment, the following are to be disregarded:
- (a) subsection 701-1(1) (the single entity rule);
  - (b) Part IIIB of the *Income Tax Assessment Act 1936*;
  - (c) any law of a foreign country that, for the purposes of a foreign tax, treats a different entity as having made the payment, or disregards the payment.

Note 1: The purpose of this subsection is to establish a uniform basis for recognising “payments” between entities across all jurisdictions. (Note that in some countries, a “payment” recognised by this subsection will not have a tax consequence because the payment is disregarded for tax purposes).

Note 2: As a consequence of paragraph (1)(a), a subsidiary member of a consolidated group or MEC group may be a hybrid payer under section 832-320 or a deducting hybrid under section 832-550 (it cannot be a reverse hybrid because of subparagraph 832-410(2)(b)(ii)).

- (2) In addition, in the case of a trust or partnership, the trust or partnership, instead of a trustee or partner, is taken, for the purposes of this Division, to do the following things:
- (a) make or receive a payment;
  - (b) hold, acquire or dispose of an asset, interest or other property;
  - (c) enter into or carry out a \*scheme or a part of a scheme.

*Identifying income or profits of entities*

- (3) A number of provisions in this Division refer to the income or profits of an entity. For the purposes of this Division, things recognised in accordance with subsection (1) or (2) as being done

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-35

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by an entity are to be taken into account in identifying the income or profits of the entity.

*Assessable income and deductions*

- (4) A reference in this Division to an amount being included in the assessable income of an entity, or being allowable, or not allowable, as a deduction to an entity, is taken to be a reference to an amount that is so included, or allowable or not allowable, as the case requires, in determining:
- (a) in the case of an entity that is a trust—the entity’s \*net income; or
  - (b) in the case of a partnership—the partnership’s net income or \*partnership loss.

*This section does not affect the interpretation of other provisions*

- (5) Nothing in this section affects whether \*tax or \*foreign income tax is imposed on an entity.
- (6) Nothing in this section limits, by implication, any other provision of this Act.

**832-35 Single entity rule otherwise not disregarded**

Subject to section 832-30, subsection 701-1(1) (the single entity rule) is not disregarded in applying this Division.

**832-40 Schemes outside Australia**

This Division applies in relation to a payment whether or not the \*scheme under which the payment is made has been or is entered into or carried out in Australia or outside Australia or partly in Australia and partly outside Australia.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**832-45 Relationship between this Division and other charging provisions in this Act**

- (1) This section applies if an amount is included in the assessable income of an entity under a provision of this Division in relation to a payment.
- (2) An amount in relation to the payment that is to be included in the assessable income of the entity under a provision (other than a provision of this Division) is to be reduced to the extent (if any) necessary to ensure that the total amount included in the entity's assessable income in relation to the payment does not exceed the amount of the payment.

*Relationship with section 230-20*

- (3) This section applies despite section 230-20 (about taxation of financial arrangements).

**832-50 Relationship between this Division and Division 820**

- (1) In determining for the purposes of this Division whether a payment gives rise to a deduction, and the amount of the deduction, disregard the effect of Division 820 (about thin capitalisation).
- (2) Nothing in this Division limits Division 820 (about thin capitalisation) in its application to reduce, or further reduce, \*debt deductions of an entity.

**832-55 Division does not affect foreign residence rules**

Nothing in this Division affects the operation of the provisions of Division 6 that provide for the significance of foreign residence for the assessability of ordinary and statutory income.

Note: Amounts included in assessable income under this Division may be ordinary or statutory income for the purposes of Division 6.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-60

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**832-60 Valuation of trading stock affected by hybrid mismatch rules**

If:

- (a) an amount of a deduction for an outgoing is disallowed under this Division; and
  - (b) the outgoing was incurred in connection with acquiring an item of \*trading stock; and
  - (c) the item is on hand at the end of an income year;
- the amount disallowed is to be disregarded in working out the \*cost, market selling value or replacement value of the item at the end of the income year under section 70-45.

**Subdivision 832-B—Concepts relating to mismatches**

**Guide to Subdivision 832-B**

**832-100 What this Subdivision is about**

This Subdivision sets out rules about identifying deduction/non-inclusion mismatches and deduction/deduction mismatches.

**Table of sections**

**Operative provisions**

832-105	When a payment gives rise to a deduction/non-inclusion mismatch
832-110	When a payment gives rise to a deduction/deduction mismatch
832-115	Disregard effect of Division in determining deductions
832-120	Meaning of <i>foreign income tax deduction</i>
832-125	Meaning of <i>subject to Australian income tax</i>
832-130	Meaning of <i>subject to foreign income tax</i>
832-135	Safe harbour for translation rates

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Operative provisions****832-105 When a payment gives rise to a deduction/non-inclusion mismatch***Australian deduction*

(1) If:

- (a) a deduction (other than a deduction that is solely attributable to a \*currency exchange rate effect) is allowable to an entity in an income year in respect of a payment (including a part or share of the payment); and
- (b) the amount of the deduction exceeds the sum of the amounts of the payment that are:
  - (i) \*subject to foreign income tax in a foreign country in a \*foreign tax period that starts no later than 12 months after the end of the income year; or
  - (ii) \*subject to Australian income tax for the income year;

then the deduction is the **deduction component** of a **deduction/non-inclusion mismatch** to which the payment gives rise.

Note: A deduction/non-inclusion mismatch might give rise to a hybrid financial instrument mismatch (see Subdivision 832-C), a hybrid payer mismatch (see Subdivision 832-D), a reverse hybrid mismatch (see Subdivision 832-E), or a branch hybrid mismatch (see Subdivision 832-F).

*Foreign income tax deduction*

(2) If:

- (a) an entity is entitled to a \*foreign income tax deduction in a foreign country in a \*foreign tax period in respect of a payment (including a part or share of the payment); and
- (b) the amount of the foreign income tax deduction exceeds the sum of the amounts of the payment that are:
  - (i) \*subject to foreign income tax in a foreign country in a foreign tax period that starts no later than 12 months

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-110

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after the end of the foreign tax period in which the foreign income tax deduction arose; or

- (ii) \*subject to Australian income tax for an income year that starts no later than 12 months after the end of the foreign tax period in which the foreign income tax deduction arose; and

- (c) the foreign income tax deduction is not solely attributable to:

- (i) any currency exchange rate fluctuations; or
- (ii) a difference between an expressly or implicitly agreed currency exchange rate for a future date or time and the applicable currency exchange rate at that date or time;

then the foreign income tax deduction is the **deduction component** of a **deduction/non-inclusion mismatch** to which the payment gives rise.

*Amount of the deduction/non-inclusion mismatch*

- (3) The amount of the \*deduction/non-inclusion mismatch is the amount of the excess worked out under paragraph (1)(b) or (2)(b), as applicable.

**832-110 When a payment gives rise to a deduction/deduction mismatch**

- (1) A payment gives rise to a **deduction/deduction mismatch** if the payment, or a part or share of the payment:
  - (a) gives rise to a \*foreign income tax deduction in a foreign country in a \*foreign tax period; and
  - (b) also gives rise to:
    - (i) a deduction in an income year; or
    - (ii) a foreign income tax deduction in a foreign country (other than the country mentioned in paragraph (a)).

Note: A deduction/deduction mismatch might give rise to a deducting hybrid mismatch (see Subdivision 832-G).

- (2) Each of the following is a **deduction component** of the \*deduction/deduction mismatch:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (a) the \*foreign income tax deduction mentioned in paragraph (1)(a);
- (b) the deduction mentioned in subparagraph (1)(b)(i), or the foreign income tax deduction mentioned in subparagraph (1)(b)(ii), as the case requires.

*Amount of the deduction/deduction mismatch*

- (3) The amount of the \*deduction/deduction mismatch is the lesser of:
  - (a) the amount of the \*foreign income tax deduction mentioned in paragraph (1)(a); and
  - (b) the sum of the amounts of the deduction, or foreign income tax deduction, mentioned in subparagraph (1)(b)(i) or (ii).

*Extended operation in relation to non-payment deductions*

- (4) This section applies in relation to the following amounts in the same way as it applies in relation to a payment:
  - (a) an amount representing the decline in value of an asset;
  - (b) an amount representing a share in the net loss of a partnership or other transparent entity.
- (5) If:
  - (a) an amount representing a share in the net loss of a partnership gives rise to a deduction; and
  - (b) in a foreign country:
    - (i) the same share in the income or profits of the partnership forms part of the tax base of an entity under a law of the foreign country dealing with \*foreign income tax (except a tax covered by subsection 832-130(7)); but
    - (ii) that share is brought to account in that tax base on an item-by-item basis, instead of on a net basis;

the amount is taken for the purposes of subsection (1) to also give rise to a \*foreign income tax deduction in the foreign country, for an amount representing the share in the net loss of the partnership,

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-115

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and equal to the amount of the deduction mentioned in paragraph (a).

- (6) For the purposes of subsection (4), a reference in this Division to the \*scheme under which a payment is made is taken to be a reference to:
- (a) if paragraph (4)(a) applies—the scheme under which the asset is held; or
  - (b) if paragraph (4)(b) applies—the scheme under which the net loss arose.

**832-115 Disregard effect of Division in determining deductions**

In determining for the purposes of this Division whether a payment gives rise to a deduction, disregard the effect of this Division.

**832-120 Meaning of *foreign income tax deduction***

- (1) An amount of a loss or outgoing is a ***foreign income tax deduction*** in a foreign country in a \*foreign tax period to which an entity is entitled, if the entity is entitled to deduct the amount in working out its tax base for the foreign tax period under a law of the foreign country dealing with \*foreign income tax (except a tax covered by subsection 832-130(7)).
- (2) To avoid doubt, an amount of a loss or outgoing may be a ***foreign income tax deduction*** in a foreign country in a \*foreign tax period even if the relevant entity's tax base is nil, or a negative amount.

*Effect of foreign hybrid mismatch rules*

- (3) In determining for the purposes of this section whether an entity is entitled to deduct an amount as mentioned in subsection (1), disregard the effect of the following:
- (a) any provisions of \*foreign hybrid mismatch rules of a foreign country;
  - (b) any provisions of another law of a foreign country relating to \*foreign income tax (except a tax covered by

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



subsection 832-130(7)) that has substantially the same effect as foreign hybrid mismatch rules.

### **832-125 Meaning of *subject to Australian income tax***

- (1) An amount of income or profits is ***subject to Australian income tax*** in an income year if it is an amount that is included in an entity's assessable income for the income year.
- (2) However, if:
  - (a) the entity is a trust or partnership; and
  - (b) the trust or partnership has \*net income for the income year; then the amount is only ***subject to Australian income tax*** to the extent it reasonably represents amounts:
    - (c) included in the assessable income of another entity for the income year (other than an entity that is a partnership or a trust); or
    - (d) for a trust—on which the trustee is liable to be assessed and to pay \*tax.

#### *Effect of CFC regimes*

- (3) An amount of income or profits of an entity is ***subject to Australian income tax*** if the amount is included under section 456 or 457 of the *Income Tax Assessment Act 1936* in the assessable income of another entity.
- (4) In determining for the purposes of this Division whether an amount of income or profits is \*subject to Australian income tax, disregard the effect of this Division, unless the contrary intention appears.

### **832-130 Meaning of *subject to foreign income tax***

- (1) An amount of income or profits is ***subject to foreign income tax*** in a foreign country in a \*foreign tax period if \*foreign income tax (except a tax covered by subsection (7)) is payable under a law of the foreign country in respect of the amount because the amount is included in the tax base of that law for the foreign tax period.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-130

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Note: Subdivision 832-C (Hybrid financial instrument mismatch) has effect as if certain amounts that are subject to a concessional rate of foreign income tax were not subject to foreign income tax: see section 832-235.

- (2) To avoid doubt, an amount of income or profits may be ***subject to foreign income tax*** in a foreign country in a \*foreign tax period even if the relevant entity's tax base is nil, or a negative amount.

*Effect of credits etc. for underlying taxes*

- (3) Despite subsection (1), if:
- (a) an amount (the ***pre-credit amount***) of income or profits would, apart from this subsection, be \*subject to foreign income tax in a foreign country; and
  - (b) an entity is entitled under the law of the foreign country to a credit, rebate or other tax concession in respect of the amount for foreign tax (other than a withholding-type tax) payable under a tax law of a different country (including Australia);
- then only so much of the pre-credit amount as reasonably represents an amount not effectively sheltered from \*foreign income tax (except a tax covered by subsection (7)) by the credit, rebate or tax concession is ***subject to foreign income tax***.

Note: This subsection is disregarded in working out whether an amount of income or profits is dual inclusion income: see subsection 832-680(3).

*Effect of "dividend received deductions" in foreign countries*

- (4) Despite subsection (1), if:
- (a) an amount (the ***pre-deduction amount***) of income or profits would, apart from this subsection, be \*subject to foreign income tax in a foreign country; and
  - (b) the amount consists of a dividend received by an entity from a company; and
  - (c) the entity is entitled to a \*foreign income tax deduction in respect of all or part of the amount of the dividend;
- then only so much of the pre-deduction amount as reasonably represents an amount not effectively sheltered from \*foreign

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

income tax (except a tax covered by subsection (7)) by the foreign income tax deduction is ***subject to foreign income tax***.

*Effect of CFC regimes*

- (5) An amount of income or profits of an entity is ***subject to foreign income tax*** if the amount is included in working out the tax base of another entity under a provision of a law of a foreign country that corresponds to section 456 or 457 of the *Income Tax Assessment Act 1936* (including a tax base that is nil, or a negative amount).

*Effect of foreign hybrid mismatch rules*

- (6) In determining for the purposes of this section whether a payment is included in a tax base of a law of a foreign country as mentioned in subsection (1), disregard the effect of the following:
- (a) any provisions of \*foreign hybrid mismatch rules of a foreign country;
  - (b) any provisions of another law of a foreign country relating to \*foreign income tax (except a tax covered by subsection (7)) that has substantially the same effect as foreign hybrid mismatch rules.

*Certain foreign taxes disregarded in this Division*

- (7) This subsection covers each of the following:
- (a) \*credit absorption tax;
  - (b) \*unitary tax;
  - (c) withholding-type tax;
  - (d) municipal tax;
  - (e) in the case of a federal foreign country—a State tax.

Note: The definitions of ***credit absorption tax*** and ***unitary tax*** are in section 770-15.

## **832-135 Safe harbour for translation rates**

If:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 832-175**

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- (a) a payment has any of the following effects:
  - (i) it gives rise to a deduction;
  - (ii) it gives rise to a \*foreign income tax deduction;
  - (iii) it is \*subject to Australian income tax;
  - (iv) it is \*subject to foreign income tax; and
- (b) for the purposes of this Division, the amount of one or more such effects is to be translated under Subdivision 960-C into an entity's \*applicable functional currency, or into Australian currency;

then it is reasonable for the purposes of item 11A of the table in subsection 960-50(6) (as modified by the regulations) to apply an exchange rate to each translation so as best to achieve a consistent measure of the extent to which the payment had each such effect.

Note: Item 11A is added to the table in subsection 960-50(6) by the regulations.

**Subdivision 832-C—Hybrid financial instrument mismatch**

**Guide to Subdivision 832-C**

**832-175 What this Subdivision is about**

This Subdivision neutralises a hybrid financial instrument mismatch if it involves a deduction, or non-inclusion, in Australia.

A deduction/non-inclusion mismatch is a hybrid financial instrument mismatch if it is attributable to hybridity in the treatment of a financial instrument or an arrangement to transfer a financial instrument, and either the relevant parties are related or the mismatch arose under a structured arrangement.

There is also an integrity rule that covers payments that are made in lieu of hybrid payments.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

This Subdivision has an extended application in relation to payments that are subject to concessional tax rates in a foreign country.

A hybrid financial instrument mismatch that is not neutralised by this Subdivision (or by foreign hybrid mismatch rules) is an offshore hybrid mismatch, which might give rise to an imported hybrid mismatch under Subdivision 832-H.

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## Operative provisions

### 832-180 Deduction not allowable—Australian primary response

- (1) This section applies to an entity if:
- (a) apart from this section, the entity would be entitled to a deduction in an income year in respect of a payment; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-185

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- (b) the deduction is the \*deduction component of a \*hybrid financial instrument mismatch to which the payment gives rise.
- (2) So much of the deduction as does not exceed the amount of the \*hybrid financial instrument mismatch is not allowable as a deduction.

**832-185 Inclusion in assessable income—Australian secondary response**

- (1) This section applies to an entity if:
  - (a) the entity is the recipient of a payment that gives rise to a \*hybrid financial instrument mismatch; and
  - (b) the \*deduction component of the mismatch is a \*foreign income tax deduction; and
  - (c) the secondary response is required (see subsection (2)).
- (2) For the purposes of paragraph (1)(c), the secondary response is required unless, in the country in which the \*foreign income tax deduction arose, the mismatch is covered by \*foreign hybrid mismatch rules that correspond to this Subdivision, or by a law that has substantially the same effect as foreign hybrid mismatch rules that correspond to this Subdivision.

*Inclusion of amount in assessable income*

- (3) An amount equal to the amount of the \*hybrid financial instrument mismatch is included in the entity's assessable income for the income year mentioned in subsection (4). The assessable income is taken to have been derived from the same source as the payment.
- (4) The income year is:
  - (a) if the \*foreign tax period in which the \*foreign income tax deduction arises falls wholly within an income year of the entity—that income year; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) if the foreign tax period in which the foreign income tax deduction arises straddles 2 income years of the entity—the earlier of those income years.

### **832-190 Exception where entity not a party to the structured arrangement**

Sections 832-180 and 832-185 do not apply to an entity in respect of a payment if:

- (a) the payment is made under a \*structured arrangement to which the entity is not a \*party; and
- (b) subsection 832-200(3) does not apply.

### **832-195 When a hybrid financial instrument mismatch is an offshore hybrid mismatch**

- (1) A \*hybrid financial instrument mismatch is an *offshore hybrid mismatch* if:
  - (a) the \*deduction component of the mismatch is a \*foreign income tax deduction; and
  - (b) no amount becomes \*subject to Australian income tax as a result of the application of section 832-185 in relation to the mismatch; and
  - (c) the mismatch is not covered by \*foreign hybrid mismatch rules that correspond to this Subdivision, or by a law that has substantially the same effect as foreign hybrid mismatch rules that correspond to this Subdivision.
- Note: An offshore hybrid mismatch might give rise to an imported hybrid mismatch: see Subdivision 832-H.
- (2) The amount of the \*offshore hybrid mismatch is the amount of the \*hybrid financial instrument mismatch.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-200

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**832-200 When a payment gives rise to a hybrid financial instrument mismatch**

- (1) A payment gives rise to a *hybrid financial instrument mismatch* if:
- (a) the payment gives rise to a \*hybrid mismatch under section 832-215 or 832-230; and
  - (b) subsection (3) or (6) applies.

Note: As a result of ordering rules in later Subdivisions, a payment that gives rise to a hybrid financial instrument mismatch does not also give rise to a hybrid mismatch under a later Subdivision of this Division.

- (2) The *deduction component* of the \*hybrid financial instrument mismatch is the \*deduction component of the \*deduction/non-inclusion mismatch.
- (3) This subsection applies if the following entities are related for the purposes of subsection (4):
- (a) the entity that made the payment;
  - (b) each entity that is a \*liable entity in respect of the income or profits of the recipient of the payment.

Note: For the definition of *liable entity*, see section 832-325.

*Related persons*

- (4) Two entities are related for the purposes of this subsection if any of the following apply:
- (a) the entities are in the same \*Division 832 control group;
  - (b) one of the entities holds a \*total participation interest of 25% or more in the other entity;
  - (c) a third entity holds a total participation interest of 25% or more in each of the entities.
- (5) For the purposes of subsection (4), treat the \*direct participation interest of an entity (the *holding entity*) in another entity (the *test entity*) as being the sum of the direct participation interests held by the holding entity and its \*associates in the test entity.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Structured arrangement*

- (6) This subsection applies if the payment is made under a \*structured arrangement.

**832-205 Meaning of *Division 832 control group***

- (1) Two or more entities are in the same ***Division 832 control group*** if any of the following apply:
- (a) each of the entities is a member of a group of entities that are consolidated for accounting purposes as a single group;
  - (b) one of the entities holds a \*total participation interest of 50% or more in each of the other entities;
  - (c) a third entity holds a total participation interest of 50% or more in each of the entities.
- (1A) If a trust is in a Division 832 control group as a result of the operation of subsection (1), then the trustee of the trust is in the same ***Division 832 control group***.
- (2) For the purposes of subsection (1), in determining a \*direct participation interest of one entity in another entity, disregard paragraph 350(1)(b) of the *Income Tax Assessment Act 1936* (rights of shareholders to vote or participate in certain decision-making).

**832-210 Meaning of *structured arrangement***

- (1) A payment that gives rise to a \*hybrid mismatch is made under a ***structured arrangement*** if:
- (a) the hybrid mismatch is priced into the terms of a \*scheme under which the payment is made; or
  - (b) it is reasonable to conclude that the hybrid mismatch is a design feature of a scheme under which the payment is made.
- (2) The question whether a \*hybrid mismatch is a design feature of a \*scheme must be determined by reference to the facts and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-215

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circumstances that exist in connection with the scheme, including the terms of the scheme.

- (3) An entity that entered into or carried out the \*scheme or any part of the scheme is a **party** to the \*structured arrangement unless:
- (a) the entity could not reasonably have been expected to be aware that the scheme gave rise to a \*hybrid mismatch; and
  - (b) no other entity in the same \*Division 832 control group as the entity could reasonably have been expected to be aware that the scheme gave rise to a hybrid mismatch; and
  - (c) the financial position of each entity in the Division 832 control group would reasonably be expected to have been the same if the scheme had not given rise to the hybrid mismatch.

**832-215 Hybrid mismatch**

- (1) A payment gives rise to a **hybrid mismatch** if:
- (a) the payment is made under any of the following:
    - (i) a \*debt interest;
    - (ii) an \*equity interest;
    - (iii) a \*derivative financial arrangement;
    - (iv) an \*arrangement covered by subsection (2); and
  - (b) the payment might reasonably be expected to give rise to a \*deduction/non-inclusion mismatch; and
  - (c) the mismatch that might reasonably be expected to arise, or a part of that mismatch, meets a hybrid requirement in section 832-220 or 832-225.

*Transfers of financial instruments*

- (2) An \*arrangement is covered by this subsection if:
- (a) the arrangement is any of the following:
    - (i) a reciprocal purchase agreement (otherwise known as a repurchase agreement);
    - (ii) a securities lending arrangement;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (iii) a similar arrangement; and
- (b) an entity acquires any of the following under the arrangement:
  - (i) a \*debt interest;
  - (ii) an \*equity interest;
  - (iii) a \*derivative financial arrangement.

*Amount of the hybrid mismatch*

- (3) The amount of the \*hybrid mismatch is:
  - (a) the amount of the \*deduction/non-inclusion mismatch, unless paragraph (b) applies; or
  - (b) if only a part of the deduction/non-inclusion mismatch meets a hybrid requirement mentioned in paragraph (1)(c)—the amount of that part of the deduction/non-inclusion mismatch.

**832-220 Hybrid requirement—payments under financial instruments**

- (1) A \*deduction/non-inclusion mismatch, or a part of such a mismatch, meets the hybrid requirement in this section if:
  - (a) the payment that gives rise to the mismatch is made under any of the following:
    - (i) a \*debt interest;
    - (ii) an \*equity interest;
    - (iii) a \*derivative financial arrangement; and
  - (b) the mismatch, or the part of the mismatch, is attributable to differences in the treatment of the debt interest, equity interest or derivative financial arrangement, arising from the terms of the interest or arrangement; and
  - (c) the exception in subsection (2) does not apply.

Example: Redeemable preferences shares that are treated under this Act as a debt interest, and in a foreign country as an equity interest.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-225

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*Exception for deferrals not exceeding 3 years*

- (2) This exception applies if:
- (a) the difference in treatment mentioned in paragraph (1)(b) primarily relates to a deferral in the recognition of income or profits under the \*debt interest, the \*equity interest or the \*derivative financial arrangement; and
  - (b) the term of the interest or arrangement is 3 years or less.

**832-225 Hybrid requirement—payments under transfers of certain financial instruments**

- (1) A \*deduction/non-inclusion mismatch, or a part of such a mismatch, meets the hybrid requirement in this section if:
- (a) the payment that gives rise to the mismatch is made under an \*arrangement covered by subsection 832-215(2); and
  - (b) the mismatch, or the part of the mismatch, is attributable to differences in the treatment of the arrangement; and
  - (c) the exception in subsection (2) of this section does not apply.

*Exception for deferrals not exceeding 3 years*

- (2) This exception applies if:
- (a) the difference in treatment mentioned in paragraph (1)(b) primarily relates to a deferral in the recognition of income or profits under the \*arrangement; and
  - (b) the term of the arrangement is 3 years or less.

**832-230 Hybrid mismatch—integrity rule for substitute payments**

- (1) A payment also gives rise to a **hybrid mismatch** if:
- (a) the payment gives rise to a \*deduction/non-inclusion mismatch; and
  - (b) the payment is made under an \*arrangement under which any of the following is transferred:
    - (i) a \*debt interest;
    - (ii) an \*equity interest;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (iii) a \*derivative financial arrangement; and
  - (c) the payment, or a part of the payment, (the ***substitute payment***) could reasonably be regarded as having been converted into a form that is in substitution for a \*return (however described) on the interest or arrangement; and
  - (d) the return is covered by subsection (2).
- (2) This subsection covers a \*return (however described) on a \*debt interest, an \*equity interest, or a \*derivative financial arrangement, that is transferred if any of the following apply:
- (a) the return is made to the payer of the substitute payment, and is not \*subject to foreign income tax or \*subject to Australian income tax;
  - (b) the return is not made to the payer of the substitute payment, but if it had been it would not have been subject to foreign income tax or subject to Australian income tax;
  - (c) if the return were instead made to the payee of the substitute payment:
    - (i) it would be subject to foreign income tax or subject to Australian income tax; or
    - (ii) it would give rise to a \*hybrid mismatch under section 832-215.

*Amount of the hybrid mismatch*

- (3) The amount of the \*hybrid mismatch is the amount of the \*deduction/non-inclusion mismatch.

**832-235 Extended operation of this Subdivision in relation to concessional foreign taxes**

- (1) This section applies in working out, for the purposes of this Subdivision, whether an amount is \*subject to foreign income tax.
- (2) An amount of income or profits of an entity is treated as if it were *not* \*subject to foreign income tax if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-240

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- (a) apart from this section, the amount would be \*subject to foreign income tax; and
- (b) the rate of \*foreign income tax (except a tax covered by subsection 832-130(7)) (the **lower rate**) on the amount under the law of the relevant foreign country is lower than the rate (the **ordinary rate**) that would ordinarily be imposed on interest income derived by an entity of that kind in the foreign country.

*Amount of a deduction/non-inclusion mismatch*

- (3) However, for the purposes of working out the amount of a \*deduction/non-inclusion mismatch that is affected by this section, the amount of a payment that is treated by this section as not being \*subject to foreign income tax is to be discounted by multiplying it by the following fraction:

$$\frac{\text{Lower rate}}{\text{Ordinary rate}}$$

where:

**lower rate** means the lower rate mentioned in paragraph (2)(b).

**ordinary rate** means the ordinary rate mentioned in paragraph (2)(b).

**832-240 Adjustment if hybrid financial instrument payment is income in a later year**

- (1) There is an adjustment under this section for an entity in an income year (the **adjustment year**) if:
  - (a) an amount was not allowable as a deduction for the entity in an earlier income year under section 832-180 in respect of a payment that gave rise to a \*hybrid financial instrument mismatch; and
  - (b) an amount (the **taxed amount**) of the payment is:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (i) \*subject to foreign income tax in a foreign country in a \*foreign tax period that ends within 12 months after the end of the adjustment year; or
  - (ii) \*subject to Australian income tax in the adjustment year.
- (2) The taxed amount is an amount the entity can deduct in the adjustment year.
- (2A) Subsection (2) does not apply if, on the assumption that subsections 832-180(2) and 832-725(6) were disregarded, no amount would have been allowable as a deduction in respect of the payment because of subsection 832-725(3).
- (3) The total amounts deducted under this section in respect of a payment must not exceed the amount that was not allowable as a deduction in respect of the payment as mentioned in paragraph (1)(a).

*No adjustment for concessional taxes*

- (4) This section does not apply if the \*hybrid mismatch would not have arisen apart from section 832-235.

## **Subdivision 832-D—Hybrid payer mismatch**

### **Guide to Subdivision 832-D**

#### **832-280 What this Subdivision is about**

This Subdivision neutralises a hybrid payer mismatch if it involves a deduction, or non-inclusion, in Australia.

A deduction/non-inclusion mismatch is a hybrid payer mismatch if it is made by a hybrid payer, and the mismatch would not have arisen, or would have been less, if the payment had instead been made by an ungrouped entity. It is also a requirement that the relevant parties are in the same control group or the mismatch arose under a structured arrangement.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-285

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An entity is a hybrid payer if a payment it makes is disregarded for the purposes of the tax law of one country (resulting in non-inclusion), but is deductible for the purposes of the tax law of another country.

The neutralising amount for the hybrid payer mismatch is reduced by dual inclusion income.

A hybrid payer mismatch that is not neutralised by this Subdivision (or by foreign hybrid mismatch rules) is an offshore hybrid mismatch, which might give rise to an imported hybrid mismatch under Subdivision 832-H.

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832-325	Meaning of <i>liable entity</i>
832-330	Neutralising amount
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**Operative provisions**

**832-285 Deduction not allowable—Australian primary response**

- (1) This section applies to an entity if:
- (a) apart from this section, the entity would be entitled to a deduction in an income year in respect of a payment; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



- (b) the deduction is the \*deduction component of a \*hybrid payer mismatch to which the payment gives rise.
- (2) So much of the deduction as does not exceed the \*neutralising amount for the \*hybrid payer mismatch is not allowable as a deduction.

Note: The neutralising amount is worked out under section 832-330.

### **832-290 Inclusion in assessable income—Australian secondary response**

- (1) This section applies to an entity if:
  - (a) the entity is the recipient of a payment that gives rise to a \*hybrid payer mismatch; and
  - (b) the \*deduction component of the mismatch is a \*foreign income tax deduction; and
  - (c) the secondary response is required (see subsection (2)).

#### *When secondary response is required*

- (2) For the purposes of paragraph (1)(c), the secondary response is required unless, in the country in which the \*foreign income tax deduction arose, the mismatch is covered by \*foreign hybrid mismatch rules that correspond to this Subdivision, or by a law that has substantially the same effect as foreign hybrid mismatch rules that correspond to this Subdivision.

#### *Inclusion of amount in assessable income*

- (3) An amount equal to the \*neutralising amount for the \*hybrid payer mismatch is included in the entity's assessable income for the income year mentioned in subsection (4). The assessable income is taken to have been derived from the same source as the payment.
- (4) The income year (the ***inclusion year***) is:
  - (a) if the \*foreign tax period in which the \*foreign income tax deduction arises falls wholly within an income year of the entity—that income year; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-295

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- (b) if the foreign tax period in which the foreign income tax deduction arises straddles 2 income years of the entity—the earlier of those income years.

**832-295 Exception where entity not a party to the structured arrangement**

Sections 832-285 and 832-290 do not apply to an entity in respect of a payment if:

- (a) the payment is made under a \*structured arrangement to which the entity is not a \*party; and
- (b) subsection 832-305(3) does not apply.

**832-300 When a hybrid payer mismatch is an offshore hybrid mismatch**

- (1) A \*hybrid payer mismatch is an *offshore hybrid mismatch* if:
  - (a) the \*deduction component of the mismatch is a \*foreign income tax deduction; and
  - (b) no amount becomes \*subject to Australian income tax as a result of the application of section 832-290 in relation to the mismatch; and
  - (c) the mismatch is not covered by \*foreign hybrid mismatch rules that correspond to this Subdivision, or by a law that has substantially the same effect as foreign hybrid mismatch rules that correspond to this Subdivision.

Note: An offshore hybrid mismatch might give rise to an imported hybrid mismatch: see Subdivision 832-H.

- (2) The amount of the \*offshore hybrid mismatch is the \*neutralising amount for the \*hybrid payer mismatch.

**832-305 When a payment gives rise to a hybrid payer mismatch**

- (1) A payment gives rise to a *hybrid payer mismatch* if:
  - (a) the payment gives rise to a \*hybrid mismatch under section 832-310; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

(b) subsection (3) or (4) applies.

- (2) The **deduction component** of the \*hybrid payer mismatch is the \*deduction component of the \*deduction/non-inclusion mismatch mentioned in section 832-310.

*Control group*

- (3) This subsection applies if the following entities are in the same \*Division 832 control group:
- (a) the \*hybrid payer;
  - (b) each entity that is a \*liable entity in respect of the income or profits of the hybrid payer.

Note: For the meaning of **Division 832 control group**, see section 832-205.

*Structured arrangement*

- (4) This subsection applies if the payment is made under a \*structured arrangement.

Note: For the meaning of **structured arrangement**, see section 832-210.

## **832-310 Hybrid mismatch**

- (1) A payment gives rise to a **hybrid mismatch** if:
- (a) the payment gives rise to a \*deduction/non-inclusion mismatch; and
  - (b) the payment meets the hybrid requirement in section 832-315.

*Amount of the hybrid mismatch*

- (2) The amount of the \*hybrid mismatch is the lesser of:
- (a) the amount of the \*deduction/non-inclusion mismatch; and
  - (b) if there is an excess under either subparagraph 832-315(2)(b)(i) or 832-315(3)(b)(i)—the amount of the excess.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-315

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*Ordering rule*

- (3) However, a payment does not give rise to a **hybrid mismatch** under this section if it gives rise to a \*hybrid financial instrument mismatch.

**832-315 Hybrid requirement—assume payment was made to same recipient but by an ungrouped payer**

- (1) The payment meets the hybrid requirement in this section if:
- (a) the payment is made by a \*hybrid payer; and
  - (b) subsection (2) or (3) applies.

*Payment would have been taxed in Australia*

- (2) This subsection applies if:
- (a) the non-including country identified in subsection 832-320(3) is Australia; and
  - (b) either:
    - (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to Australian income tax for an income year was instead worked out on the assumption in subsection (4); or
    - (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch.

*Payment would have been taxed in a foreign country*

- (3) This subsection applies if:
- (a) the non-including country identified in subsection 832-320(3) is a foreign country; and
  - (b) either:
    - (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

mismatch if the amount of the payment that was  
 \*subject to foreign income tax for a \*foreign tax period  
 was instead worked out on the assumption in  
 subsection (4); or

- (ii) on the assumption in subsection (4), the payment would  
 have given rise to a \*hybrid financial instrument  
 mismatch.

*Assumption—payer was an ungrouped entity*

- (4) For the purposes of subsections (2) and (3), assume that the  
 payment had instead been made:
- (a) to the same recipient; but
  - (b) by an entity that was a \*liable entity in the non-including  
 country identified in subsection 832-320(3) only in respect of  
 its own income or profits.

Note: For the meaning of *liable entity*, see section 832-325.

### **832-320 Hybrid payer**

- (1) An entity (the *test entity*) is a *hybrid payer* in relation to a payment  
 it makes if:
- (a) subsection (2) applies to the entity in relation to a country  
 and the payment; and
  - (b) subsection (3) applies to the entity in relation to a different  
 country and the payment.

Note: The entity, the payments it makes, and its income or profits are  
 generally identified disregarding tax provisions: see section 832-30.

*Deducting country—entity is not grouped with recipient*

- (2) This subsection applies to a test entity in relation to a country (the  
*deducting country*) and a payment the test entity makes if:
- (a) the test entity, or another entity, is a \*liable entity in the  
 deducting country in respect of income or profits of the test  
 entity (or a part of those income or profits); and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) that liable entity is *not* also a liable entity in the deducting country in respect of income or profits of the recipient of the payment.

*Non-including country—entity is grouped with recipient*

- (3) This subsection applies to a test entity in relation to a country (a **non-including country**) and a payment the test entity makes if:
  - (a) the test entity, or another entity, is a \*liable entity in the non-including country in respect of income or profits of the test entity (or a part of the income or profits); and
  - (b) that liable entity is also a liable entity in the non-including country in respect of income or profits of the recipient of the payment.

**832-325 Meaning of *liable entity***

*Entity is a taxpayer in respect of its own income or profits*

- (1) An entity is a **liable entity**, in a country, in respect of its income or profits if:
  - (a) for Australia:
    - (i) \*tax is imposed on the entity in respect of all or part of its income or profits for an income year; or
    - (ii) the entity is a \*public trading trust (including a trust that makes a choice under section 703-50 (Choice to consolidate a consolidatable group)); or
    - (iii) the entity is an entity to which Division 295 (about superannuation entities) applies; and
  - (b) for a foreign country—\*foreign income tax (except a tax covered by subsection 832-130(7)) is imposed under the law of the foreign country:
    - (i) on the entity in respect of all or part of its income or profits for a \*foreign tax period; or
    - (ii) on the income or profits of the entity in a way that corresponds to the way that foreign income tax is imposed under the law of that country on the income or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

profits of a company (regardless whether the foreign income tax is actually imposed on that entity, or another entity).

Note 1: The entity, and its income or profits, are generally identified disregarding tax provisions: see section 832-30.

Note 2: An example is an entity that is a company (and is not a subsidiary member of a consolidated group or MEC group). In Australia, a company is the liable entity in respect of its income or profits.

*Entity is a taxpayer in respect of another entity's income or profits*

(2) An entity is a **liable entity**, in a country, in respect of the income or profits of another entity (the **test entity**) if:

- (a) for Australia—\*tax is imposed on the entity in respect of all or part of the income or profits of the test entity for an income year; and
- (b) for a foreign country—\*foreign income tax (except a tax covered by subsection 832-130(7)) is imposed under the law of the foreign country on the entity in respect of all or part of the income or profits of the test entity for a \*foreign tax period.

Note 1: The test entity, and its income or profits, are generally identified disregarding tax provisions: see section 832-30.

Note 2: An example is a test entity that is a partnership. In Australia, each partner in the partnership is a liable entity in respect of the income or profits of the partnership.

(2A) However, an entity is not a **liable entity** in a country in respect of the income or profits of a test entity under subsection (2) if the test entity is the liable entity in that country in respect of the income or profits as a result of the operation of subparagraph (1)(a)(ii), (a)(iii) or (b)(ii).

(3) To avoid doubt, the following outcomes may arise under subsection (2) in a country:

- (a) there may be one or more \*liable entities in respect of the income or profits of a test entity;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) there may be one or more interposed entities between the test entity and an entity that is a liable entity in respect of the income or profits of the test entity.

*Entity not required to be actually liable to pay tax or foreign income tax*

- (4) To avoid doubt, an entity may be a \*liable entity in respect of its own, or another entity's, income or profits in a country even if any of the following situations exist:
  - (a) there are no actual income or profits;
  - (b) there are income or profits, but no part of the income or profits is:
    - (i) for Australia—\*subject to Australian income tax; or
    - (ii) for a foreign country—\*subject to foreign income tax in that foreign country;
  - (c) the entity is not actually liable to pay an amount of \*tax or \*foreign income tax.

Note: In determining whether an entity is a liable entity in such a situation, assume that income or profits within the tax base of the country exist.

*Effect of CFC regimes*

- (5) An entity is not a **liable entity** in respect of income or profits of another entity (the **test entity**) merely because all or part of the income or profits of the test entity are:
  - (a) included under section 456 or 457 of the *Income Tax Assessment Act 1936* in the assessable income of the other entity; or
  - (b) included under a corresponding provision of a law of a foreign country in working out the tax base of the other entity (including a tax base of nil, or a negative amount).

**832-330 Neutralising amount**

- (1) The **neutralising amount** for a \*hybrid payer mismatch is the amount of the \*hybrid mismatch from subsection 832-310(2),

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



reduced (but not below nil) by the amount of any \*dual inclusion income that is available to be applied in working out the neutralising amount.

*Australian deduction—inclusions must be in Australia and in the non-including country*

- (2) An amount of \*dual inclusion income is available to be applied to reduce the \*neutralising amount for a \*hybrid payer mismatch to which section 832-285 applies if:
- (a) the \*hybrid payer is eligible to apply the amount (see subsection 832-680(7)); and
  - (b) the amount is \*subject to Australian income tax for the purposes of subsection 832-680(1) in the income year mentioned in subsection 832-285(1); and
  - (c) the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the non-including country identified in subsection 832-320(3).

Note: Section 832-680 modifies the meanings of subject to Australian income tax and subject to foreign income tax for the purpose of working out dual inclusion income.

*Australian non-inclusion—inclusions must be in Australia and in the deducting country*

- (3) An amount of \*dual inclusion income is available to be applied to reduce the \*neutralising amount for a \*hybrid payer mismatch to which section 832-290 applies if:
- (a) the \*hybrid payer is eligible to apply the amount (see subsection 832-680(7)); and
  - (b) the amount is \*subject to Australian income tax for the purposes of subsection 832-680(1) in the inclusion year mentioned in subsection 832-290(4); and
  - (c) the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the deducting country mentioned in subsection 832-320(2).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Offshore hybrid mismatch—inclusions must be in the deducting country and the non-including country*

- (4) An amount of \*dual inclusion income is available to be applied to reduce the \*neutralising amount for a \*hybrid payer mismatch that is an \*offshore hybrid mismatch if:
- (a) the \*hybrid payer is eligible to apply the amount (see subsection 832-680(7)); and
  - (b) in the same \*foreign tax period as the period in which the \*foreign income tax deduction arose, the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the deducting country mentioned in subsection 832-320(2); and
  - (c) the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the non-including country identified in subsection 832-320(3).

**832-335 Adjustment if hybrid payer has dual inclusion income in a later year**

- (1) There is an adjustment under this section for an entity in an income year (the *adjustment year*) if:
- (a) in an earlier income year, all or part of a deduction of the entity in respect of a payment that gave rise to a \*hybrid payer mismatch was not allowable under section 832-285; and
  - (b) an amount of \*dual inclusion income is:
    - (i) available to be applied by the \*hybrid payer in the adjustment year; and
    - (ii) \*subject to Australian income tax for the purposes of subsection 832-680(1) in the adjustment year; and
    - (iii) \*subject to foreign income tax for the purposes of subsection 832-680(1) in the non-including country identified in subsection 832-320(3).
- (2) So much of the amount of \*dual inclusion income that satisfies paragraph (1)(b) as does not exceed the amount that was not

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

allowable as a deduction is an amount the entity can deduct in the adjustment year.

- (3) For the purposes of a later application of this section, treat the amount that was not allowable as a deduction under section 832-285 as being reduced by the amount deducted under subsection (2) of this section.

## **Subdivision 832-E—Reverse hybrid mismatch**

### **Guide to Subdivision 832-E**

#### **832-375 What this Subdivision is about**

This Subdivision neutralises a reverse hybrid mismatch if it involves a deduction in Australia.

A deduction/non-inclusion mismatch is a reverse hybrid mismatch if it is made directly or indirectly to a reverse hybrid, and the mismatch would not have arisen, or would have been less, if the payment had instead been made directly to an investor in the reverse hybrid.

An entity is a reverse hybrid if it is transparent for the purposes of the tax law of the country in which it is formed, but non-transparent for the purposes of the tax law of the country in which investors in it are subject to tax (resulting in non-inclusion).

A reverse hybrid mismatch that is not neutralised by this Subdivision (or by foreign hybrid mismatch rules) is an offshore hybrid mismatch, which might give rise to an imported hybrid mismatch under Subdivision 832-H.

### **Table of sections**

#### **Operative provisions**

832-380 Deduction not allowable—Australian primary response

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 832-380

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- 832-385 Exception where entity not a party to the structured arrangement
- 832-390 When a reverse hybrid mismatch is an offshore hybrid mismatch
- 832-395 When a payment gives rise to a reverse hybrid mismatch
- 832-400 Hybrid mismatch
- 832-405 Hybrid requirement—assume payment was made to an investor
- 832-410 Reverse hybrid

### Operative provisions

#### 832-380 Deduction not allowable—Australian primary response

- (1) This section applies to an entity if:
  - (a) apart from this section, the entity would be entitled to a deduction in an income year in respect of a payment; and
  - (b) the deduction is the \*deduction component of a \*reverse hybrid mismatch to which the payment gives rise.
- (2) So much of the deduction as does not exceed the amount of the \*reverse hybrid mismatch is not allowable as a deduction.

#### 832-385 Exception where entity not a party to the structured arrangement

Section 832-380 does not apply to an entity in respect of a payment if:

- (a) the payment is made under a \*structured arrangement to which the entity is not a \*party; and
- (b) subsection 832-395(3) does not apply.

#### 832-390 When a reverse hybrid mismatch is an offshore hybrid mismatch

- (1) A \*reverse hybrid mismatch is an *offshore hybrid mismatch* if:
  - (a) the \*deduction component of the mismatch is a \*foreign income tax deduction; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the country in which the foreign income tax deduction arose does not have <sup>\*</sup>foreign hybrid mismatch rules that correspond to this Subdivision.

Note: An offshore hybrid mismatch might give rise to an imported hybrid mismatch: see Subdivision 832-H.

- (2) The amount of the <sup>\*</sup>offshore hybrid mismatch is the amount of the <sup>\*</sup>reverse hybrid mismatch.

### **832-395 When a payment gives rise to a reverse hybrid mismatch**

- (1) A payment gives rise to a **reverse hybrid mismatch** if:
- (a) the payment gives rise to a <sup>\*</sup>hybrid mismatch under section 832-400; and
  - (b) subsection (3) or (4) applies.
- (2) The **deduction component** of the <sup>\*</sup>reverse hybrid mismatch is the <sup>\*</sup>deduction component of the <sup>\*</sup>deduction/non-inclusion mismatch mentioned in section 832-400.

#### *Control group*

- (3) This subsection applies if the following entities are in the same <sup>\*</sup>Division 832 control group:
- (a) the entity that made the payment;
  - (b) the <sup>\*</sup>reverse hybrid;
  - (c) each entity that is an investor identified in paragraph 832-410(2)(c) in relation to the reverse hybrid.

Note: For the meaning of **Division 832 control group**, see section 832-205.

#### *Structured arrangement*

- (4) This subsection applies if the payment is made under a <sup>\*</sup>structured arrangement.

Note: For the meaning of **structured arrangement**, see section 832-210.

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<sup>\*</sup>To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-400

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**832-400 Hybrid mismatch**

- (1) A payment gives rise to a *hybrid mismatch* if:
- (a) the payment gives rise to a \*deduction/non-inclusion mismatch; and
  - (b) the payment meets the hybrid requirement in section 832-405.

*Amount of the hybrid mismatch*

- (2) The amount of the \*hybrid mismatch is the lesser of:
- (a) the amount of the \*deduction/non-inclusion mismatch; and
  - (b) if there is an excess under either subparagraph 832-405(2)(b)(i) or (3)(b)(i)—the amount of the excess.

*Ordering rule*

- (3) A payment does not give rise to a *hybrid mismatch* under this section if it gives rise to a \*hybrid financial instrument mismatch or a \*hybrid payer mismatch.

**832-405 Hybrid requirement—assume payment was made to an investor**

- (1) The payment meets the hybrid requirement in this section if:
- (a) the payment is made directly, or indirectly through one or more interposed entities, to a \*reverse hybrid; and
  - (b) subsection (2) or (3) applies.

*Payment would have been taxed in Australia*

- (2) This subsection applies if:
- (a) the investor country identified in subsection 832-410(3) is Australia; and
  - (b) either:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to Australian income tax for an income year was instead worked out on the assumption in subsection (4); or
- (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch or a \*reverse hybrid mismatch.

*Payment would have been taxed in a foreign country*

- (3) This subsection applies if:
  - (a) the investor country identified in subsection 832-410(3) is a foreign country; and
  - (b) either:
    - (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to foreign income tax for a \*foreign tax period was instead worked out on the assumption in subsection (4); or
    - (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch or a \*reverse hybrid mismatch.

*Assumption—payment was made to the investing taxpayer*

- (4) For the purposes of subsections (2) and (3), assume that the payment had instead been made:
  - (a) by the same entity; but
  - (b) directly to the investing taxpayer identified in paragraph 832-410(3)(a) or (b).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-410

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**832-410 Reverse hybrid**

- (1) An entity (the **test entity**) is a **reverse hybrid** in relation to a payment made to it if:
- (a) subsection (2) applies to the entity in relation to a country and the payment; and
  - (b) subsection (3) applies to the entity in relation to a different country and the payment.

Note: The entity, the payments it makes, and its income or profits are generally identified disregarding tax provisions: see section 832-30.

*Formation country—entity is transparent and payment is not within the tax base*

- (2) This subsection applies to a test entity in relation to a country (the **formation country**) and a payment made to the entity if:
- (a) the test entity is formed in the formation country; and
  - (b) for the formation country, the test entity is:
    - (i) not a **\*liable entity**; and
    - (ii) for Australia—not a **\*member** of a **\*consolidated group** or **\*MEC group**; and
  - (c) for the formation country, another entity (an **investor**) is a liable entity in respect of income or profits of the test entity.

Note: For the meaning of **liable entity**, see section 832-325.

*Investor country—entity is not transparent*

- (3) This subsection applies to a test entity in relation to a country (the **investor country**) and a payment made to the entity if, in the investor country:
- (a) an investor identified in paragraph (2)(c) is a **\*liable entity** (an **investing taxpayer**) in respect of its own income or profits, but not in respect of the test entity's income or profits; or
  - (b) an entity that is a liable entity (also an **investing taxpayer**) in respect of the investor's income or profits is not also a liable entity in respect of the test entity's income or profits.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



**Subdivision 832-F—Branch hybrid mismatch****Guide to Subdivision 832-F****832-450 What this Subdivision is about**

This Subdivision neutralises a branch hybrid mismatch if it involves a deduction in Australia (and the non-inclusion was not also in Australia).

A deduction/non-inclusion mismatch is a branch hybrid mismatch if it is made directly or indirectly to a branch hybrid, and the mismatch would not have arisen, or would have been less, if the residence country had not recognised the permanent establishment.

An entity is a branch hybrid in relation to a payment made to it if, for the purposes of the tax law of the country in which it is a resident, the payment is treated as being allocated to a permanent establishment in another country, but in the other country, the payment is treated as *not* being allocated to a permanent establishment in that country.

A branch hybrid mismatch that is not neutralised by this Subdivision (or by foreign hybrid mismatch rules) is an offshore hybrid mismatch, which might give rise to an imported hybrid mismatch under Subdivision 832-H.

**Table of sections****Operative provisions**

832-455	Deduction not allowable
832-460	Exception where entity not a party to the structured arrangement
832-465	When a branch hybrid mismatch is an offshore hybrid mismatch
832-470	Branch hybrid mismatch
832-475	Hybrid mismatch
832-480	Hybrid requirement—payment made directly or indirectly to a branch hybrid

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 832-455

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832-485 Branch hybrid

### Operative provisions

#### 832-455 Deduction not allowable

- (1) This section applies to an entity if:
  - (a) apart from this section, the entity would be entitled to a deduction in an income year in respect of a payment; and
  - (b) the deduction is the \*deduction component of a \*branch hybrid mismatch to which the payment gives rise.
- (2) So much of the deduction as does not exceed the amount of the \*branch hybrid mismatch is not allowable as a deduction.
- (3) However, this section does not apply in relation to the \*branch hybrid mismatch if subsection 23AH(2) of the *Income Tax Assessment Act 1936* does not apply in relation to the payment because of subsection (4A) of that section.

#### 832-460 Exception where entity not a party to the structured arrangement

Section 832-455 does not apply to an entity in respect of a payment if:

- (a) the payment is made under a \*structured arrangement to which the entity is not a \*party; and
- (b) subsection 832-470(3) does not apply.

#### 832-465 When a branch hybrid mismatch is an offshore hybrid mismatch

- (1) A \*branch hybrid mismatch is an *offshore hybrid mismatch* if:
  - (a) the \*deduction component of the mismatch is a \*foreign income tax deduction; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the country in which the foreign income tax deduction arose does not have \*foreign hybrid mismatch rules that correspond to this Subdivision; and
- (c) subsection 23AH(4A) of the *Income Tax Assessment Act 1936* does not apply in relation to the branch hybrid mismatch.

Note: An offshore hybrid mismatch might give rise to an imported hybrid mismatch: see Subdivision 832-H.

- (2) The amount of the \*offshore hybrid mismatch is the amount of the \*branch hybrid mismatch.

### **832-470 Branch hybrid mismatch**

- (1) A payment gives rise to a **branch hybrid mismatch** if:
  - (a) the payment gives rise to a \*hybrid mismatch under section 832-475; and
  - (b) subsection (3) or (4) applies.
- (2) The **deduction component** of the \*branch hybrid mismatch is the \*deduction component of the \*deduction/non-inclusion mismatch mentioned in section 832-475.

#### *Control group*

- (3) This subsection applies if the following entities are in the same \*Division 832 control group:
  - (a) the entity that made the payment;
  - (b) the \*branch hybrid.

Note: For the meaning of **Division 832 control group**, see section 832-205.

#### *Structured arrangement*

- (4) This subsection applies if the payment is made under a \*structured arrangement.

Note: For the meaning of **structured arrangement**, see section 832-210.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-475

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**832-475 Hybrid mismatch**

- (1) A payment gives rise to a **hybrid mismatch** if:
- (a) the payment gives rise to a \*deduction/non-inclusion mismatch; and
  - (b) the mismatch, or a part of the mismatch, meets the hybrid requirement in section 832-480.

*Amount of the hybrid mismatch*

- (2) The amount of the \*hybrid mismatch is the lesser of:
- (a) the amount of the \*deduction/non-inclusion mismatch; and
  - (b) if there is an excess under either subparagraph 832-480(2)(b)(i) or (3)(b)(i)—the amount of the excess.

*Ordering rule*

- (3) A payment does not give rise to a **hybrid mismatch** under this section if it gives rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch or a \*reverse hybrid mismatch.

**832-480 Hybrid requirement—payment made directly or indirectly to a branch hybrid**

- (1) The payment meets the hybrid requirement in this section if:
- (a) the payment is made directly, or indirectly through one or more interposed entities, to a \*branch hybrid; and
  - (b) subsection (2) or (3) applies.

*Payment would have been taxed in Australia*

- (2) This subsection applies if:
- (a) the residence country identified in subsection 832-485(2) is Australia; and
  - (b) either:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to Australian income tax for an income year was instead worked out on the assumption in subsection (4); or
- (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch or a \*hybrid payer mismatch.

*Payment would have been taxed in a foreign country*

- (3) This subsection applies if:
  - (a) the residence country identified in subsection 832-485(2) is a foreign country; and
  - (b) either:
    - (i) the amount of the \*deduction/non-inclusion mismatch exceeds the amount that would be the amount of that mismatch if the amount of the payment that was \*subject to foreign income tax for a \*foreign tax period was instead worked out on the assumption in subsection (4); or
    - (ii) on the assumption in subsection (4), the payment would have given rise to a \*hybrid financial instrument mismatch or a \*hybrid payer mismatch.

*Assumption—residence country treated payment as non-branch income*

- (4) For the purposes of subsections (2) and (3), assume that the payment was instead treated as income derived by the \*liable entity but not in carrying on a business at or through a \*PE in another country for the purposes of:
  - (a) if the residence country is Australia—this Act; or
  - (b) if the residence country is a foreign country—the law of the residence country relating to \*foreign income tax (except a tax covered by subsection 832-130(7)).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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### 832-485 Branch hybrid

- (1) An entity is a **branch hybrid**, in relation to a payment made to the entity, if:
- (a) subsection (2) applies to the entity in relation to a country and a payment; and
  - (b) subsection (4) applies to the entity in relation to the payment.

*Residence country applies branch profits exemption*

- (2) This subsection applies to an entity in relation to a country (the **residence country**) and a payment made to the entity if, for that country:
- (a) the entity satisfies the residency test in subsection 832-555(9) and is a \*liable entity in respect of its own income or profits; and
  - (b) the payment is treated as income derived by the liable entity in carrying on a business at or through a \*PE in another country; and
  - (c) as a result of an exemption or other tax concession to which that liable entity is entitled in respect of income derived in carrying on a business at or through the PE, the payment is not:
    - (i) if the residence country is Australia—\*subject to Australian income tax; or
    - (ii) if the residence country is a foreign country—\*subject to foreign income tax in that foreign country.

Note: For the meaning of **liable entity**, see section 832-325.

- (3) In determining whether subparagraph (2)(c)(i) is satisfied, disregard the effect of subsection 23AH(4A) of the *Income Tax Assessment Act 1936*.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Branch country fails to tax payment*

- (4) This subsection applies to an entity in relation to the other country mentioned in paragraph (2)(b) (the **branch country**) and a payment made to the entity if:
- (a) the payment is treated as *not* having been derived in carrying on a business at or through a \*PE of the entity, or as otherwise not having a sufficient connection to a taxable presence in the branch country, for the purposes of:
    - (i) if the branch country is Australia—this Act; or
    - (ii) if the branch country is a foreign country—the law of the branch country relating to \*foreign income tax (except a tax covered by subsection 832-130(7)); and
  - (b) as a result, the payment is not:
    - (i) if the branch country is Australia—\*subject to Australian income tax; or
    - (ii) if the branch country is a foreign country—\*subject to foreign income tax in that foreign country.

*Modified meaning of permanent establishment*

- (5) Subsection (6) applies if:
- (a) the residence country has entered into, with the branch country:
    - (i) if either the residence country or the branch country is Australia—an \*international tax agreement; or
    - (ii) if subparagraph (i) does not apply—a treaty or other agreement relating to the avoidance of double taxation and the prevention of fiscal evasion with respect to taxes on income and capital; and
  - (b) the agreement or treaty (as the case requires) contains:
    - (i) if either the residence country or the branch country is Australia—a \*permanent establishment article; or
    - (ii) if subparagraph (i) does not apply—a provision corresponding to a permanent establishment article.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (6) A reference in this section to a \*PE in a country is taken to be a reference to a permanent establishment within the meaning of the relevant agreement or treaty in the country.

**Subdivision 832-G—Deducting hybrid mismatch**

**Guide to Subdivision 832-G**

**832-525 What this Subdivision is about**

This Subdivision neutralises a deducting hybrid mismatch if it involves a deduction in Australia.

A deduction/deduction mismatch is generally a deducting hybrid mismatch.

An entity is a deducting hybrid if a payment it makes is deductible for the purposes of the tax law of 2 countries.

However, unless the deducting hybrid is a dual resident, there are rules identifying which country is the primary response country. If Australia is *not* the primary response country, this Subdivision will not neutralise the deducting hybrid mismatch unless:

- (a) the primary response country does not have hybrid mismatch rules; and
- (b) the relevant parties are in the same control group, or the mismatch arose under a structured arrangement.

The neutralising amount for the deducting hybrid mismatch is reduced by dual inclusion income.

A deducting hybrid mismatch that is not neutralised by this Subdivision (or by foreign hybrid mismatch rules) is an offshore hybrid mismatch, which might give rise to an imported hybrid mismatch under Subdivision 832-H.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



**Table of sections****Operative provisions**

832-530	Deduction not allowable
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832-545	When an amount gives rise to a deducting hybrid mismatch
832-550	Deducting hybrid
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832-560	Neutralising amount
832-565	Adjustment if deducting hybrid has dual inclusion income in a later year

**Operative provisions****832-530 Deduction not allowable**

- (1) This section applies to an entity if:
  - (a) apart from this section, the entity would be entitled to a deduction in an income year; and
  - (b) the deduction is a \*deduction component of a \*deducting hybrid mismatch.
- (2) So much of the deduction as does not exceed the \*neutralising amount for the \*deducting hybrid mismatch is not allowable as a deduction.

Note: The neutralising amount is worked out under section 832-560.

**832-535 Additional requirements for secondary response**

- (1) However, if there is a secondary response country in relation to the \*deducting hybrid mismatch (see section 832-555), and that country is Australia, section 832-530 does not apply in relation to the \*deducting hybrid mismatch unless:
  - (a) the secondary response is required (see subsection (2)); and
  - (b) subsection (3) or (4) applies.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-540

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*When secondary response is required*

- (2) For the purposes of paragraph (1)(a), the secondary response is required unless:
- (a) a \*liable entity in respect of the income or profits of the \*deducting hybrid satisfies the residency test in subsection 832-555(9) in the primary response country; and
  - (b) in the primary response country, the mismatch is covered by \*foreign hybrid mismatch rules that correspond to this Subdivision, or by a law that has substantially the same effect as foreign hybrid mismatch rules that correspond to this Subdivision.

*Control group*

- (3) This subsection applies if the following entities are in the same \*Division 832 control group:
- (a) the \*deducting hybrid;
  - (b) if one or more entities other than the deducting hybrid is a \*liable entity in respect of the income or profits of the deducting hybrid in a deducting country—each such liable entity.

Note: For the meaning of **Division 832 control group**, see section 832-205.

*Structured arrangement*

- (4) This subsection applies if the payment is made under a \*structured arrangement.

Note 1: For the meaning of **structured arrangement**, see section 832-210.

Note 2: If the deduction is a non-payment deduction, see also subsection 832-110(5).

**832-540 When a deducting hybrid mismatch is an offshore hybrid mismatch**

- (1) A \*deducting hybrid mismatch is an **offshore hybrid mismatch** if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (a) the only \*deduction components of the mismatch are \*foreign income tax deductions; and
- (b) the mismatch is not covered by \*foreign hybrid mismatch rules that correspond to this Subdivision, or by a law that has substantially the same effect as foreign hybrid mismatch rules that correspond to this Subdivision, in any country in which a foreign income tax deduction arose.

Note: An offshore hybrid mismatch might give rise to an imported hybrid mismatch: see Subdivision 832-H.

- (2) The amount of the \*offshore hybrid mismatch is the \*neutralising amount for the \*deducting hybrid mismatch.

### **832-545 When an amount gives rise to a deducting hybrid mismatch**

- (1) A payment or other amount gives rise to a **deducting hybrid mismatch** if there is a \*deducting hybrid in relation to the payment or other amount.
- (2) Each \*deduction component of the \*deduction/deduction mismatch mentioned in paragraph 832-550(a) is a **deduction component** of the \*deducting hybrid mismatch.
- (3) A \*deducting hybrid mismatch is also a **hybrid mismatch**.

#### *Ordering rule*

- (4) However, a payment does not give rise to a **deducting hybrid mismatch** if it gives rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch, a \*reverse hybrid mismatch or a \*branch hybrid mismatch.

### **832-550 Deducting hybrid**

An entity is a **deducting hybrid** in relation to a payment or other amount if:

- (a) the payment or other amount gives rise to a \*deduction/deduction mismatch; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-555

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- (b) the entity is:
  - (i) for a payment—the entity that makes the payment; or
  - (ii) for an amount that represents the decline in value of a depreciating asset (see paragraph 832-110(4)(a))—the entity that holds the asset; or
  - (iii) for an amount that represents a share in the net loss of a partnership or other transparent entity (see paragraph 832-110(4)(b))—an entity that has an interest in the partnership or other transparent entity; and
- (c) the entity:
  - (i) is a \*liable entity in one deducting country (but not both); or
  - (ii) satisfies the residency test in subsection 832-555(9) in both deducting countries, and is also a liable entity in both deducting countries; or
  - (iii) is a \*member of a \*consolidated group or a \*MEC group.

**832-555 Identifying a secondary response country**

- (1) This section applies if an amount gives rise to a \*deducting hybrid mismatch, other than a deducting hybrid mismatch covered by subsection (2).

*Dual residents—no secondary response*

- (2) This subsection covers a \*deducting hybrid mismatch if:
  - (a) the only \*liable entity in respect of income or profits of the \*deducting hybrid is the deducting hybrid; and
  - (b) the liable entity satisfies the residency test in subsection (9) in both deducting countries.

Note 1: For the meaning of *liable entity*, see section 832-325.

Note 2: If the deducting hybrid is a dual resident, the mismatch may be neutralised by any country.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Country is a primary response country unless this section provides otherwise*

- (3) A country in which the amount gives rise to a deduction or \*foreign income tax deduction (a **deducting country**) is a primary response country in relation to the \*deducting hybrid mismatch unless the country is identified as the secondary response country under subsection (4), (5), (6), (7) or (8).

*Both countries recognise the same liable entity—residence country is secondary response*

- (4) If:
- (a) the \*deducting hybrid is itself the \*liable entity in each deducting country; and
  - (b) in one deducting country, the deducting hybrid does not satisfy the residency test in subsection (9); and
  - (c) in the other deducting country, the deducting hybrid *does* satisfy the residency test;
- then the country mentioned in paragraph (b) is the secondary response country.
- (5) If:
- (a) in both deducting countries, the same entity is the \*liable entity in respect of the income or profits of the \*deducting hybrid; and
  - (b) in one deducting country, the liable entity does not satisfy the residency test in subsection (9); and
  - (c) in the other deducting country, the liable entity *does* satisfy the residency test;
- then the country mentioned in paragraph (b) is the secondary response country.

*Countries recognise different liable entities—non-parent country is secondary response*

- (6) If:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) the \*liable entity for one deducting country is a different entity to the entity that is the liable entity for the other deducting country; and
  - (b) in one deducting country, the \*deducting hybrid is the liable entity;then the country mentioned in paragraph (b) is the secondary response country.
- (7) If:
  - (a) the \*liable entity for one deducting country is a different entity to the entity that is the liable entity for the other deducting country; and
  - (b) the \*deducting hybrid is not the liable entity in either country; and
  - (c) in one deducting country, the entity that is a liable entity is also a liable entity in respect of the income or profits of the entity that is the liable entity in the other deducting country;then the country mentioned second in paragraph (c) is the secondary response country.
- (8) If:
  - (a) the \*liable entity for one deducting country is a different entity to the entity that is the liable entity for the other deducting country; and
  - (b) subsections (6) and (7) do not apply; and
  - (c) in one deducting country, the deducting hybrid and the liable entity both satisfy the residency test in subsection (9);then the country mentioned in paragraph (c) is the secondary response country.

*Residency test*

- (9) An entity satisfies the residency test in this subsection in relation to a country, if:
  - (a) if the country is Australia—the entity is an \*Australian entity; or
  - (b) if the country is a foreign country:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (i) the entity is a resident of the foreign country for the purposes of the law of the foreign country relating to \*foreign income tax (except a tax covered by subsection 832-130(7)); or
- (ii) the tax base of the entity, as it relates to foreign income tax (except a tax covered by subsection 832-130(7)), includes income from worldwide sources.

**832-560 Neutralising amount**

- (1) The **neutralising amount** for a \*deducting hybrid mismatch is worked out by:
  - (a) starting with the lesser of the amounts of each deduction or \*foreign income tax deduction to which the amount gives rise; and
  - (b) reducing (but not below nil) the result from paragraph (a) by the amount of any \*dual inclusion income that is available to be applied in working out the neutralising amount.

*Australian deduction—inclusions must be in Australia and in the other deducting country*

- (2) An amount of \*dual inclusion income is available to be applied to reduce the \*neutralising amount for a \*deducting hybrid mismatch to which section 832-530 applies if:
  - (a) the \*deducting hybrid is eligible to apply the amount (see subsection 832-680(7)); and
  - (b) the amount is \*subject to Australian income tax for the purposes of subsection 832-680(1) in the income year mentioned in subsection 832-530(1); and
  - (c) the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the foreign country in which the \*foreign income tax deduction arose.

Note: Section 832-680 modifies the meanings of subject to Australian income tax and subject to foreign income tax for the purpose of working out dual inclusion income.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-565

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*Offshore hybrid mismatch—inclusions must be in the deducting countries*

- (3) An amount of \*dual inclusion income is available to be applied to reduce the \*neutralising amount for a \*deducting hybrid mismatch that is an \*offshore hybrid mismatch if:
- (a) the \*deducting hybrid is eligible to apply the amount (see subsection 832-680(7)); and
  - (b) the amount is \*subject to foreign income tax for the purposes of subsection 832-680(1) in the foreign country in which one of the \*foreign income tax deductions arose, and in the same \*foreign tax period; and
  - (c) the amount is also subject to foreign income tax for the purposes of subsection 832-680(1) in the foreign country in which another of the foreign income tax deductions arose.

**832-565 Adjustment if deducting hybrid has dual inclusion income in a later year**

- (1) There is an adjustment under this section for an entity in an income year (the *adjustment year*) if:
- (a) in an earlier income year, all or part of a deduction of the entity in respect of an amount that gave rise to a \*deducting hybrid mismatch was not allowable under section 832-530; and
  - (b) an amount of \*dual inclusion income is:
    - (i) available to be applied by the \*deducting hybrid in the adjustment year; and
    - (ii) \*subject to Australian income tax for the purposes of subsection 832-680(1) in the adjustment year; and
    - (iii) \*subject to foreign income tax for the purposes of subsection 832-680(1) in the foreign country in which the \*foreign income tax deduction arose.
- (2) So much of the amount of \*dual inclusion income that satisfies paragraph (1)(b) as does not exceed the amount that was not

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



allowable as a deduction is an amount the entity can deduct in the adjustment year.

- (2A) Subsection (2) does not apply if:
- (a) the amount that was not allowable as a deduction under section 832-530 relates to a payment; and
  - (b) on the assumption that subsection 832-530(2) were disregarded, no amount would have been allowable as a deduction in respect of the payment because of subsection 832-725(3).
- (3) For the purposes of a later application of this section, treat the amount that was not allowable as a deduction under section 832-530 as being reduced by the amount deducted under subsection (2) of this section.

## **Subdivision 832-H—Imported hybrid mismatch**

### **Guide to Subdivision 832-H**

#### **832-605 What this Subdivision is about**

This Subdivision neutralises an imported hybrid mismatch. This mismatch is an integrity rule that applies when one or more entities are interposed between a hybrid mismatch and a country that has hybrid mismatch rules.

Identifying an imported hybrid mismatch involves testing whether a hybrid mismatch involving 2 foreign countries has been “imported” into Australia by a deduction. If so, there are priority rules that allocate the neutralisation of the mismatch between countries that have hybrid mismatch rules.

### **Table of sections**

#### **Operative provisions**

832-610 Deduction not allowable

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- 832-615 When a payment gives rise to an imported hybrid mismatch
- 832-620 Hybrid mismatch
- 832-625 Meaning of *importing payment*
- 832-630 Working out the amount of the imported hybrid mismatch
- 832-635 Carry forward of residual offshore hybrid mismatches

### Operative provisions

#### 832-610 Deduction not allowable

- (1) This section applies in relation to an *\*imported hybrid mismatch* if, apart from this section, an entity would be entitled to a deduction in an income year in respect of a payment that gives rise to the imported hybrid mismatch.
- (2) So much of the deduction as does not exceed the amount of the *\*imported hybrid mismatch* is not allowable as a deduction.

Note: The amount of the imported hybrid mismatch is worked out under section 832-630.

#### 832-615 When a payment gives rise to an imported hybrid mismatch

- (1) A payment gives rise to an *imported hybrid mismatch* if:
  - (a) the payment gives rise to a *\*hybrid mismatch* under section 832-620; and
  - (b) an item in the table in subsection (2) applies to the importing payment.

Note: The amount of the imported hybrid mismatch is worked out under section 832-630.

#### *Priority rules for importing payments*

- (2) If more than one item in the following table covers an *\*importing payment* in relation to an *\*offshore hybrid mismatch*, apply the first item that covers it. However, an item does *not* apply to an importing payment if:

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*\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.*

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## Section 832-615

- (a) an item higher in the table applies to one or more other importing payments in relation to the offshore hybrid mismatch; and
- (b) the offshore hybrid mismatch is, or will be, fully neutralised by the application of this Subdivision, and equivalent provisions of applicable \*foreign hybrid mismatch rules, to those other importing payments.

**Priority table for importing payments**

<b>Item</b>	<b>Topic</b>	<b>An *importing payment is covered if:</b>
1	Structured arrangement	(a) the *importing payment is made under a *structured arrangement; and (b) the payer of the importing payment, the offshore deducting entity mentioned in paragraph 832-625(1)(c), and each interposed entity (if applicable) are all *parties to the structured arrangement
2	Direct payment	(a) the *importing payment is made directly to the offshore deducting entity mentioned in paragraph 832-625(1)(c); and (b) the payer of the importing payment and the offshore deducting entity are in the same *Division 832 control group
3	Indirect payment	(a) the *importing payment is made indirectly through one or more interposed entities to the offshore deducting entity mentioned in paragraph 832-625(1)(c); and (b) the payer of the importing payment, the offshore deducting entity, and each interposed entity are in the same *Division 832 control group

Note 1: For the meaning of *structured arrangement*, see section 832-210.

Note 2: For the meaning of *Division 832 control group*, see section 832-205.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-620

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**832-620 Hybrid mismatch**

- (1) A payment gives rise to a **hybrid mismatch** if the payment is an **\*importing payment** in relation to an **\*offshore hybrid mismatch**.

Note: For the meaning of **offshore hybrid mismatch** see sections 832-195, 832-300, 832-390, 832-465, and 832-540.

*Ordering rule*

- (2) A payment does not give rise to a **hybrid mismatch** under this section if it gives rise to a **\*hybrid financial instrument mismatch**, a **\*hybrid payer mismatch**, a **\*reverse hybrid mismatch**, a **\*branch hybrid mismatch** or a **\*deducting hybrid mismatch**.

Note: However, for an imported hybrid mismatch to arise, a different payment must have given rise to an offshore hybrid mismatch that is of one of these kinds.

**832-625 Meaning of *importing payment***

- (1) A payment an entity (the **payer**) makes is an **importing payment** in relation to an **\*offshore hybrid mismatch** if:

(a) either:

- (i) apart from section 832-610, the payment, or a part of the payment, gives rise to a deduction in an income year covered by subsection (2); or
- (ii) the payment, or a part of the payment, gives rise to a **\*foreign income tax deduction** in a foreign country that has **\*foreign hybrid mismatch rules**, in a **\*foreign tax period** covered by subsection (2); and

(b) the payment is made directly, or indirectly through one or more interposed entities, to another entity; and

(c) the other entity (the **offshore deducting entity**) is:

- (i) the entity that made the payment that gave rise to the offshore hybrid mismatch; or
- (ii) if the offshore hybrid mismatch is a **\*deducting hybrid mismatch**—the **\*deducting hybrid**.

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**\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.**

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*Period within which mismatch may be imported*

- (2) For the purposes of paragraph (1)(a), a \*foreign tax period or income year is covered by this subsection if:
- (a) it ends at or after the end of the foreign tax period in which a \*deduction component of the \*offshore hybrid mismatch arose; and
  - (b) it has at least one day in common with that period.

*Indirect importations*

- (3) For the purposes of determining whether a payment is made indirectly through one or more interposed entities to the offshore deducting entity:
- (a) it is sufficient if payments exist between each interposed entity, and it is not necessary to demonstrate that each payment in a series of payments funds the next payment, or is made after the previous payment; and
  - (b) each payment made by an interposed entity must:
    - (i) give rise to a \*foreign income tax deduction in a country that does not have \*foreign hybrid mismatch rules; and
    - (ii) not give rise to a \*deduction/non-inclusion mismatch.

*Loss surrender and grouping relief*

- (4) Subsection (5) applies if:
- (a) a payment is made to an entity (the **first entity**); and
  - (b) another entity (the **second entity**) makes a payment (the **second payment**) to a third entity; and
  - (c) the first entity and the second entity are in the same \*Division 832 control group; and
  - (d) under the law of a foreign country relating to \*foreign income tax (except a tax covered by subsection 832-130(7)):
    - (i) a \*foreign income tax deduction arises in respect of the second payment; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-630

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- (ii) the foreign income tax deduction may, as a result of a concessional feature of that law, be transferred to, shared with, or otherwise applied by, the first entity.

Note: For the meaning of **Division 832 control group**, see section 832-205.

- (5) For the purposes of this section, treat:
  - (a) a payment as having been made by the first entity to the second entity; and
  - (b) the payment as having given rise to a \*foreign income tax deduction (but not a \*deduction/non-inclusion mismatch) in the foreign country mentioned in paragraph (4)(d).

**832-630 Working out the amount of the imported hybrid mismatch**

- (1) The amount of the \*imported hybrid mismatch is the lesser of:
  - (a) the importing deduction amount worked out under subsection (2) in relation to the deduction; and
  - (b) the amount worked out using the following formula:

$$\frac{\text{Importing deduction}}{\text{Total importing deductions of equal priority}} \times \text{Remaining offshore hybrid mismatch}$$

where:

**importing deduction** means the amount of the importing deduction amount worked out under subsection (2) in relation to the deduction.

**remaining offshore hybrid mismatch** means:

- (a) unless paragraph (b) applies—the amount of the \*offshore hybrid mismatch; or
- (b) if an item higher in the table in subsection 832-615(2) applies to one or more other \*importing payments in relation to the offshore hybrid mismatch—the amount of the offshore hybrid mismatch that is not, or will not be, neutralised by the application of this Subdivision, and equivalent provisions of applicable \*foreign hybrid mismatch rules, in relation to those other importing payments.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

***total importing deductions of equal priority*** means the amount worked out by:

- (a) identifying each \*importing payment in relation to the \*offshore hybrid mismatch to which the same item in the table in subsection 832-615(2) applies; and
  - (b) working out under subsection (2) the importing deduction amount in relation to the deduction or \*foreign income tax deduction to which each such importing payment gives rise; and
  - (c) summing the results from paragraph (b) for each such importing payment.
- (2) The amount (the ***importing deduction amount***) worked out under this subsection in relation to a deduction or \*foreign income tax deduction is:
- (a) if the \*importing payment is made directly to the offshore deducting entity—the amount of the deduction or foreign income tax deduction; or
  - (b) if the importing payment is made indirectly through one or more interposed entities to the offshore deducting entity—the lesser of:
    - (i) the amount of the deduction or foreign income tax deduction; and
    - (ii) the smallest amount of any foreign income tax deduction to which a payment by an interposed entity gave rise.

### **832-635 Carry forward of residual offshore hybrid mismatches**

- (1) Subsection (2) applies if:
- (a) a payment made in a particular \*foreign tax period gave rise to an \*offshore hybrid mismatch (the ***original mismatch***); and
  - (b) the original mismatch is only partly neutralised by the application of this Subdivision and equivalent provisions of applicable \*foreign hybrid mismatch rules.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 832-675

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- (2) This Subdivision applies as if:
- (a) the offshore deducting entity had made a payment in the next \*foreign tax period; and
  - (b) the payment gave rise to an \*offshore hybrid mismatch (the *residual mismatch*); and
  - (c) the amount of the residual mismatch was the amount of the original mismatch that was not neutralised by the application of this Subdivision and equivalent provisions of applicable \*foreign hybrid mismatch rules.

**Subdivision 832-I—Dual inclusion income**

**Guide to Subdivision 832-I**

**832-675 What this Subdivision is about**

Income that is taxed in 2 countries is dual inclusion income. It can be applied to reduce the neutralising amount for the hybrid payer mismatch and the deducting hybrid mismatch.

This Subdivision modifies the concepts of “subject to Australian income tax” and “subject to foreign income tax” for the purposes of calculating dual inclusion income.

It also identifies which entities are able to apply dual inclusion income.

**Table of sections**

**Operative provisions**

832-680 Dual inclusion income, and when an entity is eligible to apply it

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Operative provisions****832-680 Dual inclusion income, and when an entity is eligible to apply it**

- (1) An amount of income or profits is **dual inclusion income** if 2 or more of the following outcomes arise for the amount:
- (a) it is \*subject to Australian income tax in an income year;
  - (b) it is \*subject to foreign income tax in a foreign country in a \*foreign tax period;
  - (c) it is subject to foreign income tax in a foreign country (other than the country mentioned in paragraph (b)) in a foreign tax period.

Note: In certain circumstances, dual inclusion income can be applied to reduce the neutralising amount for a hybrid payer mismatch (see section 832-330) or a deducting hybrid mismatch (see section 832-560).

- (1A) In determining for the purposes of subsection (1) whether an amount of income or profits is \*subject to Australian income tax, disregard subsection 832-125(2) (which is about when an amount included in the assessable income of a trust or partnership is subject to Australian income tax), so far as it applies in relation to assessable income from a foreign source.

*Effect of Australian foreign income tax offset for underlying taxes*

- (2) For the purposes of subsection (1), if:
- (a) an amount of assessable income of a \*corporate tax entity (the **assessable amount**) would, apart from this subsection and subsection (1A), be \*subject to Australian income tax; and
  - (b) an amount of \*foreign income tax (except a tax covered by subsection 832-130(7)) paid in respect of the assessable amount counts towards a \*tax offset for an entity under Division 770;

then:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-680

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- (c) if the amount of the tax offset equals or exceeds the amount of \*tax that would, having regard only to the assessable amount and the rate at which tax is imposed on the entity, be payable on the assessable amount—the assessable amount is treated as if it were not subject to Australian income tax; and
- (d) if the amount of the tax offset is a proportion of the amount of that tax—then that proportion of the assessable amount is treated as if it were not subject to Australian income tax.

*Effect of credits etc. for underlying taxes*

- (3) In determining for the purposes of subsection (1) whether an amount of income or profits is \*subject to foreign income tax in a \*foreign tax period, disregard subsection 832-130(3).

*Extension for certain on-payments through grouped entities*

- (4) Subsection (5) applies, if:
  - (a) an entity is a member of a dual inclusion income group in a country (see subsection (6)); and
  - (b) an amount of income or profits of the entity (the **on-payment amount**) is a payment received by the entity from another member of the dual inclusion income group at a time; and
  - (c) it is reasonable to conclude that the payment was funded by an amount of income or profits of the other member (the **funding income or profits**); and
  - (d) it is reasonable to conclude that the funding income or profits were:
    - (i) if the country mentioned in paragraph (a) is Australia—\*subject to Australian income tax; or
    - (ii) if the country mentioned in paragraph (a) is a foreign country—\*subject to foreign income tax in the foreign country; and
  - (e) the funding income or profits were not \*dual inclusion income under subsection (1) (disregarding subsection (5)) in the country.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (4A) In determining whether paragraph (4)(d) is satisfied, have regard to any previous application of subsection (5).
- (5) For the purposes of subsection (1), the on-payment amount is treated as if it were:
- (a) if the country mentioned in paragraph (4)(a) is Australia—  
\*subject to Australian income tax in the income year in which the time mentioned in paragraph (4)(b) occurs; or
  - (b) if the country mentioned in paragraph (4)(a) is a foreign country—\*subject to foreign income tax in the foreign country in the \*foreign tax period in which the time mentioned in paragraph (4)(b) occurs.
- (6) Two or more entities (the *member entities*) are members of a group (a *dual inclusion income group*) in a country for the purposes of this Division if in that country:
- (a) the same entity or entities are \*liable entities in respect of the income or profits of each of the member entities; and
  - (b) no other entity is a liable entity in respect of the income or profits of any of the member entities.

Note: For example, entities that are members of a consolidated group or MEC group.

*When an entity is eligible to apply dual inclusion income*

- (7) An entity is eligible to apply an amount of \*dual inclusion income if the amount is income or profits of:
- (a) the entity; or
  - (b) if paragraph (a) does not apply and the entity is a member of a dual inclusion income group in any country—an entity that is a member of the dual inclusion income group.
- (8) However, an entity is not eligible to apply the amount if it has already been applied by any entity by a previous application of a provision of this Division.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 832-720

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### *Interaction with other provisions*

- (9) To avoid doubt, if a provision of this section has the effect that an amount is treated for the purposes of subsection (1) as if it were \*subject to Australian income tax, or \*subject to foreign income tax, then that effect extends to another provision of this Act that refers to an amount that is (as the case requires):

- (a) subject to Australian income tax for the purposes of subsection (1) of this section; or
- (b) subject to foreign income tax for the purposes of subsection (1) of this section.

Note: For example, an amount that would not be subject to Australian income tax for the purposes of subsection (1) apart from subsection (1A) satisfies paragraphs 832-330(2)(b) and (3)(b) and subparagraph 832-335(1)(b)(ii).

## Subdivision 832-J—Integrity rule

### 832-720 What this Subdivision is about

This Subdivision contains an integrity measure that disallows an Australian deduction for a payment of interest (or a payment of a similar character) made by an entity (the *paying entity*) under a scheme to a foreign entity (the *interposed foreign entity*). The deduction will be disallowed if certain conditions are satisfied, including that:

- (a) the paying entity, the interposed foreign entity and another foreign entity (the *ultimate parent entity*) are in the same Division 832 control group; and
- (b) the payment is not subject to Australian income tax; and
- (c) the highest rate of foreign income tax (the *foreign country rate*) on the payment is 10% or less; and
- (d) it is reasonable to conclude (having regard to certain matters) that the entity, or one of the entities, that entered into or carried out all or part of the scheme did so for a purpose including a purpose of enabling a deduction to be obtained in respect of the payment, and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

enabling foreign income tax to be imposed on the payment at a rate of 10% or less.

However, the deduction will not be disallowed if, assuming that the payment had been made directly to the ultimate parent entity:

- (a) the rate of foreign income tax on the payment in the country of residence of the ultimate parent entity would be less than or equal to the foreign country rate; and
- (b) the payment would not give rise to a hybrid mismatch of a particular kind.

## Table of sections

### Operative provisions

- 832-725 Payments made to interposed foreign entity (integrity measure)—denial of deduction
- 832-730 Back to back arrangements, etc.
- 832-735 Determination may specify kinds of scheme and circumstances where no denial of deduction

## Operative provisions

### 832-725 Payments made to interposed foreign entity (integrity measure)—denial of deduction

- (1) Subsection (3) applies if:
  - (a) an entity (the *paying entity*) makes a payment under a \*scheme to a \*foreign entity (the *interposed foreign entity*), either directly, or indirectly through one or more interposed \*Australian trusts or Australian partnerships (within the meaning of Part X of the *Income Tax Assessment Act 1936*); and
  - (b) the paying entity, the interposed foreign entity and another foreign entity (the *ultimate parent entity*) are in the same \*Division 832 control group; and

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 832-725

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- (c) the ultimate parent entity is not controlled by any other entity (other than an entity that is not a member of the Division 832 control group); and
  - (d) the payment is of:
    - (i) an amount of interest (within the meaning of subsection 128A(1AB) of the *Income Tax Assessment Act 1936*); or
    - (ii) an amount under a \*derivative financial arrangement; and
  - (e) an entity is entitled to a deduction in an income year in respect of the payment (disregarding this section); and
  - (f) the payment is not \*subject to Australian income tax; and
  - (g) either:
    - (i) the payment is \*subject to foreign income tax in one or more foreign countries, and the highest rate (the **foreign country rate**) at which the payment is subject to foreign income tax is 10% or less; or
    - (ii) the payment is not subject to foreign income tax; and
  - (h) it is reasonable to conclude (having regard to the matters in subsection (2)) that the entity, or one of the entities, who entered into or carried out the scheme or any part of the scheme did so for a principal purpose of, or for more than one principal purpose that includes a purpose of:
    - (i) enabling a deduction to be obtained in respect of the payment; and
    - (ii) enabling foreign income tax to be imposed on the payment at a rate of 10% or less, or enabling foreign income tax not to be imposed on the payment.
- (1A) For the purposes of subsection (1), disregard paragraphs 832-130(7)(d) and (e) (exclusion of municipal and State taxes in working out what is \*subject to foreign income tax).
- (2) For the purposes of paragraph (1)(h), have regard to the following matters:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) the facts and circumstances that exist in relation to the \*scheme;
  - (b) if the payment is an amount of interest as mentioned in subparagraph (1)(d)(i)—the source of the funds used by the interposed foreign entity to provide the paying entity with the loan or other debt interest in respect of which the payment of interest is made;
  - (c) whether the interposed foreign entity engages in substantial commercial activities in carrying on a banking, financial or other similar business.
- (3) The entity mentioned in paragraph (1)(e) is not entitled to the deduction mentioned in that paragraph.
- (4) Subsection (3) does not apply if it is reasonable to conclude that:
- (a) the following requirements are satisfied:
    - (i) the amount of the payment is taken into account under Part X of the *Income Tax Assessment Act 1936*;
    - (ii) the sum of the \*attribution percentages of each \*attributable taxpayer in relation to the interposed foreign entity, for the purposes of sections 456 and 457 of that Act in respect of the income year in which the payment is made, is at least 100%; or
  - (b) requirements similar to those in paragraph (a), under the law of a foreign country that has substantially the same effect as Part X of that Act in respect of that foreign country, are satisfied in relation to the interposed foreign entity; or
  - (c) assuming that the payment were treated as being divided into 2 separate payments:
    - (i) the requirements in paragraph (a) would be satisfied in relation to one of those separate payments; and
    - (ii) the requirements in paragraph (b) would be satisfied in relation to the other of those separate payments.
- (5) Subsection (3) does not apply if it is reasonable to conclude that, assuming that the payment had been made directly to the ultimate parent entity:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Section 832-730

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- (a) the payment would:
    - (i) be \*subject to foreign income tax at a rate that is the same as, or less than, the foreign country rate; or
    - (ii) not be subject to foreign income tax; and
  - (b) the payment would not give rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch or a \*reverse hybrid mismatch.
- (6) Subsection (3) does not apply if the payment gives rise to a \*hybrid financial instrument mismatch, a \*hybrid payer mismatch, a \*reverse hybrid mismatch, a \*branch hybrid mismatch or an \*imported hybrid mismatch.
- (7) Subsection (3) does not apply to the extent that an amount to which the payment relates was not allowable as a deduction under subsection 832-530(2).

### 832-730 Back to back arrangements, etc.

- (1) Subsection (2) applies if:
- (a) an entity (the *original paying entity*) makes a payment of a kind mentioned in subparagraph 832-725(1)(d)(i) to another entity; and
  - (b) the other entity, or a further entity, pays an amount of that kind to a foreign entity; and
  - (c) the payments mentioned in paragraphs (a) and (b) are made under an arrangement involving back-to-back loans or an arrangement that is economically equivalent and intended to have a similar effect to back-to-back loans.
- (2) For the purposes of this Subdivision, treat the original paying entity as having made the payment mentioned in paragraph (1)(a) to the foreign entity mentioned in paragraph (1)(b).

### 832-735 Determination may specify kinds of scheme and circumstances where no denial of deduction

- (1) Subsection 832-725(3) does not apply if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (a) where a determination made for the purposes of paragraph (2)(a) specifies a kind of \*scheme—the scheme mentioned in subsection 832-725(1) is of that kind; or
  - (b) where a determination made for the purposes of paragraph (2)(b) specifies a kind of circumstances in relation to a scheme—circumstances of that kind exist in relation to the scheme mentioned in subsection 832-725(1).
- (2) For the purposes of subsection (1), the Minister may, by legislative instrument, make a determination that:
- (a) specifies kinds of \*schemes; and
  - (b) specifies kinds of circumstances in relation to schemes.

### **Subdivision 832-K—Modifications for Division 230 (about taxation of financial arrangements)**

#### **Guide to Subdivision 832-K**

#### **832-775 What this Subdivision is about**

This Subdivision contains modifications applying to gains and losses from financial arrangements.

#### **Table of sections**

##### **Operative provisions**

- 832-780 Section 832-20 applies to Division 230 losses
- 832-785 Adjusting Division 230 loss
- 832-790 Modifications relating to Division 230 gains and losses

#### **Operative provisions**

#### **832-780 Section 832-20 applies to Division 230 losses**

To avoid doubt, the reference in paragraph 832-20(1)(a) to a loss includes:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## Section 832-785

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- (a) a loss from a \*Division 230 financial arrangement; and
- (b) an amount treated under section 832-790 as a separate loss from a Division 230 financial arrangement.

### 832-785 Adjusting Division 230 loss

- (1) This section applies if a provision of this Division (a ***disallowing provision***) would, apart from this section, apply to make not allowable all or a part of a deduction for:
  - (a) a loss from a \*Division 230 financial arrangement; or
  - (b) an amount treated under section 832-790 as a separate loss from a Division 230 financial arrangement.
- (2) The disallowing provision does not apply.

Note: See instead section 230-522.
- (3) However, the following provisions (about adjustments) apply as if the disallowing provision had applied to make the deduction, or the part of the deduction, not allowable:
  - (a) 832-240(1)(a);
  - (b) 832-335(1)(a);
  - (c) 832-565(1)(a).

### 832-790 Modifications relating to Division 230 gains and losses

- (1) This section applies to the following:
  - (a) a gain that, apart from this Division, would be included in an entity's assessable income for an income year under Division 230;
  - (b) a loss that, apart from this Division, would be allowable as a deduction to an entity for an income year under Division 230;
  - (c) a gain or a loss that, apart from this Division, would be dealt with in accordance with subsection 230-310(4) in relation to an income year.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Separation of currency effects for Division 230 gains and losses*

- (2) For the purposes of this Division, split a gain into 2 separate gains, or a gain and a loss, as follows:
- (a) to the extent to which the gain represents a \*currency exchange rate effect, treat it as a separate gain or loss;
  - (b) to the extent that it does not represent that effect, treat it as a separate gain or loss from the \*financial arrangement to which this Division applies.
- (3) For the purposes of this Division, split a loss into 2 separate losses, or a gain and a loss, as follows:
- (a) to the extent to which the loss represents a \*currency exchange rate effect, treat it as a separate gain or loss;
  - (b) to the extent that it does not represent that effect, treat it as a separate gain or loss from the \*financial arrangement to which this Division applies.
- (4) For the purposes of this Division, assume an amount treated under paragraph (2)(b) or (3)(b) as a separate loss would, apart from this Division, be allowable as a deduction to the entity for the income year.

*This Division applies to a non-currency component that is a gain*

- (5) If there is an amount treated under paragraph (2)(b) or (3)(b) as a separate gain from a \*financial arrangement, the gain is treated as consisting of any actual payments made under the financial arrangement and taken into account in working out the amount of the gain or loss the entity made under the arrangement.
- (6) For the purposes of this Division, assume the gain is an amount that, subject to Division 6 (about effect of foreign residence), is included in the entity's assessable income.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Division 840—Withholding taxes**

### **Table of Subdivisions**

Guide to Division 840

840-M Managed investment trust withholding tax

840-S Labour mobility program withholding tax

### **Guide to Division 840**

#### **840-1 What this Division is about**

This Division provides the rules to determine if you are liable to pay income tax in respect of certain Australian sourced income paid to you, or which you are entitled to receive.

The rules are relevant for foreign residents and certain other entities.

The income tax payable is a withholding tax. The associated withholding obligations are in the *Taxation Administration Act 1953*.

Amounts on which there is a liability to pay withholding tax are non-assessable non-exempt income.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Subdivision 840-M—Managed investment trust withholding tax****Guide to Subdivision 840-M****840-800 What this Subdivision is about**

If you are a foreign resident you may be liable to pay income tax on certain amounts of Australian sourced net income (other than dividends, interest and royalties) of a withholding MIT that are either paid to you or to which you become entitled.

A beneficiary (other than a foreign pension fund) of a trust in the capacity of a trustee of another trust will not be liable to income tax on these amounts.

Amounts on which there is a liability to pay withholding tax are non-assessable non-exempt income.

**Table of sections****Operative provisions**

840-805	Liability for managed investment trust withholding tax
840-810	When managed investment trust withholding tax is payable
840-815	Certain income is non-assessable non-exempt income
840-820	Agency rules

**Operative provisions****840-805 Liability for managed investment trust withholding tax***Liability*

- (1) You are liable to pay income tax at the rate declared by the Parliament on the amount identified in subsection (2), (3) or (4) as the fund payment part if that subsection applies to you.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 840-805

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- Note 1: The tax, which is called managed investment trust withholding tax, is imposed by the *Income Tax (Managed Investment Trust Withholding Tax) Act 2008* and the rate of the tax is set out in that Act.
- Note 2: See Subdivision 12-H in Schedule 1 to the *Taxation Administration Act 1953* for provisions dealing with withholding from fund payments, and Subdivision 12A-C in that Schedule for provisions dealing with obligations to pay the Commissioner amounts analogous to such withholding in relation to AMITs.
- Note 3: This subsection does not apply to residents of information exchange countries for the first income year starting on or after the first 1 July after the day on which the *Tax Laws Amendment (Election Commitments No. 1) Act 2008* receives the Royal Assent. Subdivision 840-M of the *Income Tax (Transitional Provisions) Act 1997* applies instead.

*Payments from withholding MITs*

- (2) This subsection applies to you if:
- (a) you are paid an amount from a trust that is a \*withholding MIT in relation to an income year, or an amount is applied or dealt with as you direct by such a trust; and
  - (b) all or part of that amount (the ***fund payment part***) is represented by a \*fund payment in relation to that year; and
  - (c) you are, in respect of the fund payment part, a beneficiary (but not a beneficiary in the capacity of a trustee of another trust); and
  - (d) you are a foreign resident when you are paid the amount or when the amount is applied or dealt with as you direct.

- Note 1: Because a fund payment can be adjusted to account for earlier fund payments and the expected amounts of later fund payments (see subsection 12A-110(5) in Schedule 1 to the *Taxation Administration Act 1953*), the amount of a particular fund payment may not reflect the actual amount you are paid for the purposes of this subsection.
- Note 2: If the withholding MIT is an AMIT, under subsection 12A-205(2) in Schedule 1 to the *Taxation Administration Act 1953*, amounts may be treated, for the purposes of this Subdivision, as having been paid to you from the trustee of the AMIT.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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*Payments from custodians*

- (3) This subsection applies to you if:
- (a) you are paid an amount from a \*custodian, or an amount is applied or dealt with as you direct by a custodian; and
  - (b) all or part of that amount (the ***fund payment part***) is reasonably attributable to a \*fund payment in relation to an income year by a trust that is a \*withholding MIT in relation to that year; and
  - (c) you are, in respect of the fund payment part, a beneficiary (but not a beneficiary in the capacity of a trustee of another trust); and
  - (d) you are a foreign resident when you are paid the amount or when the amount is applied or dealt with as you direct; and
  - (e) either:
    - (i) the custodian is not a company; or
    - (ii) if it is a company, it would be acting in the capacity as your \*agent apart from section 840-820.

Note: If the withholding MIT is an AMIT, under subsection 12A-205(5) in Schedule 1 to the *Taxation Administration Act 1953*, amounts may be treated, for the purposes of this Subdivision, as having been paid to you from the custodian.

*Entitlements to amounts from other entities*

- (4) This subsection applies to you if:
- (a) you are a beneficiary of a trust (that is not a \*withholding MIT or a \*custodian) and are presently entitled to a share of the income or capital of the trust; and
  - (b) all or part of that share (also the ***fund payment part***) is reasonably attributable to a payment that is a \*fund payment in relation to an income year made by a trust that is a withholding MIT in relation to that year; and
  - (c) you are not, in respect of that share, a beneficiary in the capacity of a trustee of another trust; and
  - (d) you are a foreign resident at the time (the ***entitlement time***) when you became presently entitled.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 840-805

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*Modification—foreign pension funds*

- (4A) For the purposes of subsections (2), (3) and (4), if:
- (a) the beneficiary, in respect of a fund payment part, is a beneficiary in the capacity of a trustee of another trust; and
  - (b) the beneficiary is a \*foreign pension fund;
- the foreign pension fund is taken, in respect of that fund payment part, to be a beneficiary in its own right, and not a beneficiary in the capacity of the trustee of another trust.
- (4B) **Foreign pension fund** means:
- (a) an entity, the principal purpose of which is to fund pensions (including disability and similar benefits) for the citizens or other contributors of a foreign country, if:
    - (i) the entity is a fund established by an \*exempt foreign government agency; or
    - (ii) the entity is established under a \*foreign law for an exempt foreign government agency; or
  - (b) a \*foreign superannuation fund that has at least 50 \*members.
- (4C) If:
- (a) a \*foreign pension fund is liable to pay income tax on a fund payment part (a **taxed part**) because of the operation of subsection (4A); and
  - (b) you are a beneficiary of the foreign pension fund and are presently entitled to a share of the income or capital of the foreign pension fund;
- then, in working out for the purposes of paragraph (4)(b) whether all or part of that share is reasonably attributable to a payment that is a \*fund payment, disregard the taxed part.

*Modification—AMITs*

- (4D) If the \*managed investment trust mentioned in paragraph (2)(a), (3)(b) or (4)(b) is an \*AMIT for the income year mentioned in that paragraph:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



- (a) if paragraph (2)(a) applies—disregard the phrase “(but not a beneficiary in the capacity of a trustee of another trust)” in paragraph (2)(c); or
  - (b) if paragraph (3)(b) applies—disregard the phrase “(but not a beneficiary in the capacity of a trustee of another trust)” in paragraph (3)(c); or
  - (c) if paragraph (4)(b) applies—disregard paragraph (4)(c).
- (4E) If:
- (a) a trustee of a trust is liable to pay income tax on a fund payment part (a *taxed part*) because of the operation of subsection (4D); and
  - (b) you are a beneficiary of the trust and are presently entitled to a share of the income or capital of the trust;
- then, in working out for the purposes of paragraph (4)(b) whether all or part of that share is reasonably attributable to a payment that is a <sup>\*</sup>fund payment, disregard the taxed part.

*Entitlement to capital of a trust*

- (5) For the purposes of this section, section 95A of the *Income Tax Assessment Act 1936* applies in relation to capital of a trust in the same way as it applies to income of the trust.

*Exception—Australian permanent establishments*

- (6) This section does not apply to you if:
- (a) you are paid the fund payment part, or it is applied or dealt with as you direct; or
  - (b) you become presently entitled to it;
- in the course of a <sup>\*</sup>business you carry on at or through an <sup>\*</sup>Australian permanent establishment.

*Exception—distributions on carried interests*

- (7) Subsections (2) and (3) do not apply to you to the extent that the fund payment part:

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<sup>\*</sup>To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 840-810**

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- (a) is included in your assessable income under subsection 275-200(2) (Gains etc. from carried interests) for the income year because you hold or held a \*CGT asset that carries an entitlement to a distribution mentioned in subsection 275-200(2); or
  - (b) would be so included if subsection 275-200(3) were disregarded.
- (8) Subsection (4) does not apply to you to the extent that the fund payment part:
  - (a) is attributable to an amount included in the net income of the trust mentioned in that subsection because of subsection 275-200(2) (Gains etc. from carried interests) for the income year because the trust holds or held a \*CGT asset that carries an entitlement to a distribution mentioned in subsection 275-200(2); or
  - (b) would be so included if subsection 275-200(3) were disregarded.
- (9) Subsections (2), (3) and (4) do not apply to you to the extent that the fund payment part relates to an amount that is \*non-assessable non-exempt income of yours because of:
  - (a) Division 880; or
  - (b) Division 880 of the *Income Tax (Transitional Provisions) Act 1997*.

**840-810 When managed investment trust withholding tax is payable**

- (1) \*Managed investment trust withholding tax is due and payable by you at the end of 21 days after:
  - (a) if subsection 840-805(2) or (3) applies to you—the end of the month in which the fund payment part is paid, applied or dealt with; or
  - (b) if subsection 840-805(4) applies to you—the end of the month in which the entitlement time occurs.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (2) If any of the \*managed investment trust withholding tax that you are liable to pay remains unpaid after the time by which it is due to be paid, you are liable to pay the \*general interest charge on the unpaid amount for each day in the period that:
- (a) starts at the beginning of the day by which the withholding tax was due to be paid; and
  - (b) ends at the end of the last day on which, at the end of the day, any of the following remains unpaid:
    - (i) the withholding tax;
    - (ii) general interest charge on any of the withholding tax.

Note: The general interest charge is worked out under Part IIA of the *Taxation Administration Act 1953*.

- (3) The Commissioner may give you a notice specifying:
- (a) the amount of any \*managed investment trust withholding tax that the Commissioner has ascertained is payable by you; and
  - (b) the day on which that tax became due and payable.
- (4) The ascertainment of an amount of \*managed investment trust withholding tax is not an assessment for the purposes of this Act.
- (5) The production of a notice given under subsection (3), or of a copy of it certified by or on behalf of the Commissioner, is conclusive evidence that the notice was given and of the particulars in it.

### **840-815 Certain income is non-assessable non-exempt income**

- (1) An amount on which \*managed investment trust withholding tax is payable is not assessable income and is not \*exempt income of an entity.
- (2) Subsection (1) does not apply to an Australian resident to the extent that:
- (a) \*managed investment trust withholding tax is payable on the amount because of subsection 840-805(4D); and
  - (b) the Australian resident is entitled, directly or indirectly, to the amount.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 840-820

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**840-820 Agency rules**

- (1) This section applies to:
  - (a) a payment (the *first payment*) made to a \*custodian in the capacity as \*agent for another entity; and
  - (b) another payment made by the custodian to the extent that it is reasonably attributable to the first payment.
- (2) This Subdivision has effect as if the \*custodian were not an \*agent in relation to the payments.

**Subdivision 840-S—Labour mobility program withholding tax**

**Guide to Subdivision 840-S**

**840-900 What this Subdivision is about**

If you are a foreign resident who is employed under a labour mobility program, you may be liable to pay income tax on the salary, wages etc. paid to you under that program.

Amounts on which there is a liability to pay the tax are non-assessable non-exempt income.

**Table of sections**

**Operative provisions**

840-905	Liability for labour mobility program withholding tax
840-906	Covered labour mobility programs
840-910	When labour mobility program withholding tax is payable
840-915	Certain income is non-assessable non-exempt income
840-920	Overpayment of labour mobility program withholding tax

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## Operative provisions

### 840-905 Liability for labour mobility program withholding tax

You are liable to pay income tax at the rate declared by the Parliament on income:

- (a) that is salary, wages, commission, bonuses or allowances paid to you as an employee of an Approved Employer under a program covered by section 840-906; and
- (b) that you \*derive at a time when you are a foreign resident and:
  - (i) you hold a Temporary Work (International Relations) Visa (subclass 403); or
  - (ii) you hold a Temporary Activity Visa (subclass 408) having previously held a Temporary Work (International Relations) Visa (subclass 403); or
  - (iii) you hold a visa of a kind prescribed by the regulations for the purposes of this subparagraph.

Note 1: The tax, which is called labour mobility program withholding tax, is imposed by the *Income Tax (Labour Mobility Program Withholding Tax) Act 2012* and the rate of the tax is set out in that Act.

Note 2: See Subdivision 12-FC in Schedule 1 to the *Taxation Administration Act 1953* for provisions dealing with withholding from the salary, wages etc. You are entitled to a credit under section 18-33 in that Schedule for amounts withheld from your salary, wages etc. under that Subdivision.

### 840-906 Covered labour mobility programs

This section covers the following programs:

- (a) the Seasonal Labour Mobility Program;
- (b) the Pacific Australia Labour Mobility scheme;
- (c) each program prescribed by the regulations for the purposes of this paragraph.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 840-910

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**840-910 When labour mobility program withholding tax is payable**

- (1) \*Labour mobility program withholding tax is due and payable by you at the end of 21 days after the end of the income year in which you \*derived the income to which the tax relates.
- (2) If any of the \*labour mobility program withholding tax that you are liable to pay remains unpaid after the time by which it is due to be paid, you are liable to pay the \*general interest charge on the unpaid amount for each day in the period that:
  - (a) starts at the beginning of the day by which the withholding tax was due to be paid; and
  - (b) ends at the end of the last day on which, at the end of the day, any of the following remains unpaid:
    - (i) the withholding tax;
    - (ii) general interest charge on any of the withholding tax.

Note: The general interest charge is worked out under Part IIA of the *Taxation Administration Act 1953*.

- (3) The Commissioner may give you a notice specifying:
  - (a) the amount of any \*labour mobility program withholding tax that the Commissioner has ascertained is payable by you; and
  - (b) the day on which that tax became due and payable.
- (4) The ascertainment of an amount of \*labour mobility program withholding tax is not an assessment for the purposes of this Act.
- (5) The production of a notice given under subsection (3), or of a copy of it certified by or on behalf of the Commissioner, is, except in proceedings under Part IVC of this Act on a review or appeal relating to the notice, conclusive evidence that the notice was given and of the particulars in it.
- (6) You may object, in the manner set out in Part IVC of the *Taxation Administration Act 1953*, against a notice given to you under subsection (3) of this section, if you are dissatisfied with the notice.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**840-915 Certain income is non-assessable non-exempt income**

An amount on which \*labour mobility program withholding tax is payable is not assessable income and is not \*exempt income.

**840-920 Overpayment of labour mobility program withholding tax**

If \*labour mobility program withholding tax has been overpaid:

- (a) the Commissioner must refund the amount overpaid; and
- (b) the employee is not entitled to a credit under section 18-33 in Schedule 1 to the *Taxation Administration Act 1953* in respect of the amount overpaid.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Division 842—Exempt Australian source income and gains of foreign residents**

### **Table of Subdivisions**

- 842-B Some items of Australian source income of foreign residents that are exempt from income tax
- 842-I Investment manager regime

### **Subdivision 842-B—Some items of Australian source income of foreign residents that are exempt from income tax**

#### **Guide to Subdivision 842-B**

#### **842-100 What this Subdivision is about**

If you are a foreign resident, some of the income you derive while in Australia, or from Australian sources, may be exempt income.

#### **Table of sections**

- 842-105 Amounts of Australian source ordinary income and statutory income that are exempt

#### **842-105 Amounts of Australian source ordinary income and statutory income that are exempt**

The amounts of \*ordinary income and \*statutory income covered by the table are exempt from income tax. In some cases, the exemption is subject to exceptions or special conditions, or both.

Note 1: Ordinary and statutory income that is exempt from income tax is called exempt income: see section 6-20. The note to subsection 6-15(2) describes some of the other consequences of it being exempt income.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 842-105

Note 2: Even if an exempt payment is made to you, the Commissioner can still require you to lodge an income tax return or information under section 161 of the *Income Tax Assessment Act 1936*.

<b>Exempt amounts</b>			
<b>Item</b>	<b>If you are:</b>	<b>the following amounts are exempt from income tax:</b>	<b>subject to these exceptions and special conditions:</b>
1	a foreign resident	your remuneration paid by an *Australian government agency	the remuneration is paid to you: (a) for expert advice to that agency; or (b) as a member of a Royal Commission
2	a foreign resident who is: (a) the representative of the government of a foreign country, visiting Australia on behalf of that government; or (b) a member of the entourage of such a representative	your *ordinary income, and your *statutory income, in your official capacity as such a representative or member	none

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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<b>Exempt amounts</b>			
<b>Item</b>	<b>If you are:</b>	<b>the following amounts are exempt from income tax:</b>	<b>subject to these exceptions and special conditions:</b>
3	a foreign resident visiting Australia: (a) in the capacity of representative of any society or association established for educational, scientific, religious or philanthropic purposes; and (b) for the purpose of attending an international conference, or for the purpose of carrying on investigation or research for the society or association	your * ordinary income, and your * statutory income, in that capacity	none
4	a foreign resident visiting Australia: (a) in the capacity of representative of the media outside Australia; and (b) for the purpose of reporting the proceedings relating to any of the matters referred to in items 2 and 3	your * ordinary income, and your * statutory income, in that capacity	none
5	a member of the naval, military or air forces of the government of a foreign country	pay and allowances you earn in Australia as a member of those forces	the pay and allowances are not paid or provided by the Commonwealth

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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<b>Exempt amounts</b>			
<b>Item</b>	<b>If you are:</b>	<b>the following amounts are exempt from income tax:</b>	<b>subject to these exceptions and special conditions:</b>
6	a foreign resident visiting Australia	your * ordinary income, and your * statutory income, that: (a) is from an occupation you carry on while in Australia; and (b) is not exempt from income tax in the country where you are ordinarily resident	in the opinion of the Minister, the visit and occupation are principally directed to assisting in the defence of Australia
7	(a) a foreign resident pursuing in Australia a course of study or training; and (b) in Australia for the sole purpose of pursuing that course	your * ordinary income, and your * statutory income, by way of a scholarship, bursary, or other educational allowance, provided by the Commonwealth	none

## Subdivision 842-I—Investment manager regime

### Guide to Subdivision 842-I

#### 842-200 What this Subdivision is about

This Subdivision sets out rules about the taxation of some foreign residents (known as IMR entities) that invest into or through Australia.

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 842-205

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Income and capital gains from IMR financial arrangements are not subject to Australian income tax. Deductions and capital losses from IMR financial arrangements are disregarded for the purposes of this Act.

**Table of sections**

**Object of this Subdivision**

842-205 Object of this Subdivision

**IMR concessions**

842-210 IMR concessions apply only to foreign residents etc.

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842-220 Meaning of *IMR entity*

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**IMR widely held entities**

842-230 Meaning of *IMR widely held entity*

842-235 Rules for determining total participation interests for the purposes of the widely held test

842-240 Extended meaning of *IMR widely held entity*—temporary circumstances outside entity's control

**Independent Australian fund managers**

842-245 Meaning of *independent Australian fund manager*

842-250 Reductions in IMR concessions if independent Australian fund manager entitled to substantial share of IMR entity's income

**Object of this Subdivision**

**842-205 Object of this Subdivision**

The object of this Subdivision is to encourage particular kinds of investment made into or through Australia by some foreign residents that have wide membership, or that use Australian fund managers.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

## IMR concessions

### 842-210 IMR concessions apply only to foreign residents etc.

- (1) This Subdivision applies only for the purposes of working out the assessable income of an entity (the *foreign entity*) that:
  - (a) is a foreign resident; and
  - (b) is *not* a trust or partnership.
- (2) Despite subsection (1), this Subdivision applies in relation to a partnership or trust, to the extent necessary to work out an amount included in the assessable income of the foreign entity.

Note 1: This Subdivision applies, for example, in working out the net income of a partnership or trust, to the extent necessary to work out the assessable income, attributable to that partnership or trust, of a partner or beneficiary who is a foreign resident.

Note 2: This Subdivision could operate in relation to an entity (if it is a partnership or trust) and/or one or more partnerships or trusts interposed between the entity and the foreign resident.

### 842-215 IMR concessions

#### *Concessions relating to IMR financial arrangements*

- (1) The following consequences apply to an \*IMR entity for an income year in relation to an \*IMR financial arrangement if the requirements of subsection (3) or (5) are met in relation to the year:
  - (a) what would otherwise be the entity's assessable income for the year is \*non-assessable non-exempt income of the entity, to the extent that it is attributable to a return or gain:
    - (i) from the arrangement (if the arrangement is a \*derivative financial arrangement); or
    - (ii) from the entity disposing of, ceasing to own or otherwise realising the arrangement;
  - (b) an amount is not deductible by the entity for the year, to the extent that it is attributable to an outgoing or loss:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 842-215**

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- (i) from the arrangement (if the arrangement is a derivative financial arrangement); or
- (ii) from the entity disposing of, ceasing to own or otherwise realising the arrangement;
- (c) disregard a \*capital gain or \*capital loss that is from a \*CGT event that happens in the year in relation to the arrangement.

*Further concessions relating to permanent establishments*

- (2) Without limiting subsection (1), the following further consequences apply to an \*IMR entity for an income year if the requirements of subsection (5) are met in relation to the year:
  - (a) income that relates to or arises under the \*IMR financial arrangement, and that would otherwise be the entity's assessable income for the year, is \*non-assessable non-exempt income of the entity, to the extent that the income:
    - (i) if the entity is resident in a country that has entered into an \*international tax agreement with Australia containing a \*business profits article—is treated as having a source in Australia because it is attributable to a permanent establishment (within the meaning of the relevant international tax agreement) of the entity in Australia; or
    - (ii) if subparagraph (i) does not apply—is treated as having a source in Australia because of subsection 815-230(1);
  - (b) an amount is not deductible by the entity for the year, to the extent that it is attributable to gaining income that is non-assessable non-exempt income of the entity because of paragraph (a);
  - (c) disregard a \*capital gain or \*capital loss that is from a \*CGT event that relates to or arises under the IMR financial arrangement, and that happens in the year in relation to a \*CGT asset that:
    - (i) is covered by item 3 of the table in section 855-15 in relation to the entity; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (ii) is covered by item 4 of the table in section 855-15 in relation to the entity because it is an option or right to \*acquire a CGT asset covered by item 3 of that table in relation to the entity.

*Direct investment by IMR widely held entity*

- (3) The requirements of this subsection in relation to the year are that:
  - (a) during the whole of the year, the \*IMR entity is an \*IMR widely held entity; and
  - (b) during the whole of the year, the interest of the entity in the issuer of, or counterparty to, the \*IMR financial arrangement does not pass the \*non-portfolio interest test (see section 960-195); and
  - (c) none of the returns, gains or losses for the year from the arrangement are attributable to:
    - (i) if the entity is a resident of a country that has entered into an \*international tax agreement with Australia containing a \*permanent establishment article—a permanent establishment (within the meaning of the relevant international tax agreement) of the entity in Australia; or
    - (ii) otherwise—a \*permanent establishment of the entity in Australia; and
  - (d) the IMR entity does not, during the year, carry on in Australia a trading business (within the meaning of section 102M of the *Income Tax Assessment Act 1936*) that relates (directly or indirectly) to the arrangement; and
  - (e) subsection 842-225(2) does not apply to the IMR financial arrangement.
- (4) For the purposes of paragraph (3)(a), disregard any part of the year during which the entity did not exist.

*Indirect investment through independent Australian fund manager*

- (5) The requirements of this subsection in relation to the year are that:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 842-215

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- (a) the \*IMR financial arrangement was made, on the \*IMR entity's behalf, by an entity that is an \*independent Australian fund manager for the IMR entity for the income year (see section 842-245); and
- (b) if the issuer of, or counterparty to:
  - (i) the IMR financial arrangement referred to in paragraph (a), if it is a \*financial arrangement; or
  - (ii) otherwise—the IMR financial arrangement to which that arrangement relates;is an Australian resident, or a \*resident trust for CGT purposes—during the whole of the year, the interest of the entity in the issuer or counterparty does not pass the \*non-portfolio interest test (see section 960-195); and
- (c) the IMR entity does not, during the year, carry on in Australia a trading business (within the meaning of section 102M of the *Income Tax Assessment Act 1936*) that relates (directly or indirectly) to the arrangement.

*Withholding taxes etc.*

- (6) If what would otherwise be the \*IMR entity's assessable income is \*non-assessable non-exempt income of the entity because of subsection (1) or (2), for the purposes of determining an entity's liability to pay, in relation to that income:
  - (a) \*withholding tax; or
  - (b) an amount that must be withheld under Division 12 in Schedule 1 to the *Taxation Administration Act 1953* (even if the amount is not withheld);assume that any \*independent Australian fund manager for the IMR entity is not a \*permanent establishment of the IMR entity.
- (7) For the purposes of subparagraphs (2)(a)(i) and (3)(c)(i), an entity is taken to be a resident of a country that has entered into an \*international tax agreement with Australia if the entity is such a resident within the meaning of that agreement.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



### **842-220 Meaning of *IMR entity***

An entity is an ***IMR entity*** for an income year if the entity:

- (a) is not an Australian resident at all times during the income year; and
- (b) is not a \*resident trust for CGT purposes for the income year.

### **842-225 Meaning of *IMR financial arrangement***

- (1) A \*financial arrangement is an ***IMR financial arrangement*** unless it is or relates to a \*CGT asset that is:
  - (a) \*taxable Australian real property (see section 855-20); or
  - (b) an \*indirect Australian real property interest (see section 855-25).
- (2) Without limiting subsection (1), a sub-underwriting arrangement that is not a \*financial arrangement is an ***IMR financial arrangement*** if it was entered into by an \*IMR entity for the purpose of providing for the entity to invest or trade in a financial arrangement that is an IMR financial arrangement under subsection (1).

## **IMR widely held entities**

### **842-230 Meaning of *IMR widely held entity***

- (1) An ***IMR widely held entity*** is any of the following:
  - (aa) a \*widely held entity;
    - (a) an entity that is covered by paragraph 275-20(4)(a), (b), (c), (d), (e), (g), (h), (i) or (ia);
    - (c) an entity of a kind specified in regulations made for the purposes of this paragraph.
- (2) An entity is a ***widely held entity*** if:
  - (a) either:
    - (i) no other entity has a \*total participation interest in the entity of 20% or more (see section 842-235); or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 842-235

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- (ii) there are not 5 or fewer other entities the sum of whose total participation interests in the entity is 50% or more (see section 842-235); or
- (b) the entity has never satisfied the requirements of paragraph (a), but investment in the entity is being actively marketed with the intention that the entity satisfies the requirements of that paragraph; or
- (c) the reason for failing to satisfy the requirements of paragraph (a) relates to the entity's activities and investments being wound down.

**842-235 Rules for determining total participation interests for the purposes of the widely held test**

- (1) For the purposes of subsection 842-230(2), apply the rules in this section in determining an entity's \*total participation interest in another entity (the *test entity*).
- (2) If an entity has, through one or more interposed entities, an \*indirect participation interest in the test entity, treat each of those interposed entities as having a \*total participation interest in the test entity of nil.
- (3) If the test entity is a trust, do not treat an object of the trust as having a \*direct participation interest or \*indirect participation interest in the test entity.
- (4) Treat the following (the *affiliated entities*):
  - (a) an entity;
  - (b) each of the entity's \*affiliates;as together being one entity, that has all of the interests and rights of the affiliated entities.

Note: Such interests and rights may give rise to a participation interest in the test entity.
- (5) If an entity (the *nominee*) has interests and rights in the capacity of nominee of another entity:
  - (a) treat the nominee as *not* having those interests and rights; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (b) instead, treat the other entity as having those interests and rights (in addition to the other entity's interests and rights apart from this subsection).
- (6) If an entity that has a \*direct participation interest or \*indirect participation interest in the test entity is an entity covered by:
  - (a) paragraph 842-230(1)(a), (b) or (c); or
  - (b) paragraph 275-20(4)(f) (foreign collective investment vehicles with a wide membership);treat the entity's \*total participation interest in the test entity as nil.
- (7) The application of subsection (6) to an entity that has a \*direct participation interest or \*indirect participation interest in the test entity does not affect the \*total participation interest in the test entity of any other entity that has a direct participation interest or indirect participation interest in the test entity.
- (8) In determining a \*direct participation interest of one entity in another entity, disregard paragraph 350(1)(b) of the *Income Tax Assessment Act 1936* (rights of shareholders to vote or participate in certain decision-making).
- (9) If the test entity is an \*IMR entity and another entity is an independent fund manager for the test entity, in determining the \*total participation interest of the other entity, or any entity \*connected with the other entity, in the test entity, disregard any direct or indirect entitlements (including contingent entitlements) of the other entity, or connected entity, to remuneration from the test entity:
  - (a) to the extent that the remuneration is subject to income tax in relation to the income year for which the consequences (if any) under subsection 842-215(1) or (2) are being determined in relation to the test entity; and
  - (b) to the extent that the remuneration is subject to taxation in relation to that income year under a \*foreign law.

Example: Assume that 4 entities have interests in an IMR entity, as follows:

- (a) a life insurance company has a 55% interest;
- (b) an endowment fund has a 5% interest;

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 842-240**

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- (c) company A has a 25% interest. It has 2 shareholders (who are not affiliated): shareholder Y holds 60% of the shares and shareholder Z holds 40%;
- (d) company B has a 15% interest. It has several shareholders.

The IMR entity is an IMR widely held entity because:

- (e) under subsection 842-235(6), the life insurance company has a total participation interest of nil, as it is covered by paragraph 275-20(4)(a); and
- (f) the endowment fund has a total participation interest below the 20% threshold in subparagraph 842-230(2)(a)(i); and
- (g) under subsection 842-235(2), company A's 25% interest is divided between shareholder Y (15%) and shareholder Z (10%), and company A is treated as having a total participation interest in the IMR entity of nil; and
- (h) company B's 15% interest is below the 20% threshold, so none of its shareholders can have a total participation interest above that threshold. (In these circumstances, it is not necessary to determine the total participation interests for each of those shareholders.)

(Treating the life insurance company's 55% interest as a total participation interest of nil ensures that no summing of the other total participation interest can exceed the 50% threshold in subparagraph 842-230(2)(a)(ii).)

**842-240 Extended meaning of *IMR widely held entity*—temporary circumstances outside entity's control**

Without limiting section 842-230, an entity is an ***IMR widely held entity*** if:

- (a) apart from a particular circumstance, the entity would be an *\*IMR widely held entity* because of section 842-230; and
- (b) the circumstance is temporary; and
- (c) the circumstance arose outside the entity's control; and
- (d) it is fair and reasonable to treat the entity as an IMR widely held entity, having regard to the following matters:
  - (i) the matters in paragraphs (b) and (c);
  - (ii) the nature of the circumstance;
  - (iii) the actions (if any) taken by the entity to address or remove the circumstance, and the speed with which such actions are taken;

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*\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.*

- (iv) any other relevant matter.

## **Independent Australian fund managers**

### **842-245 Meaning of *independent Australian fund manager***

- (1) An entity (the *managing entity*) is an *independent Australian fund manager* for an \*IMR entity for an income year if:
- (a) the managing entity is an Australian resident; and
  - (b) the managing entity carries out investment management activities for the IMR entity in the ordinary course of \*business; and
  - (c) the managing entity's remuneration for carrying out those activities is what the remuneration would be between parties dealing at \*arm's length; and
  - (d) one or more of the following applies:
    - (i) the IMR entity is an \*IMR widely held entity;
    - (ii) 70% or less of the managing entity's income, for the income year, is income received from the IMR entity or entities \*connected with the IMR entity;
    - (iii) if the managing entity has been carrying out investment management activities for 18 months or less—it takes all reasonable steps to ensure that the proportion of its income received from the IMR entity or entities connected with the IMR entity, for the income year in which that 18 month period ends, will be reduced to 70% or less.
- (2) In applying paragraph (1)(c), have regard to the documents covered by section 815-135.

### **842-250 Reductions in IMR concessions if independent Australian fund manager entitled to substantial share of IMR entity's income**

- (1) The application of section 842-215 to an \*IMR entity for an income year is modified, as provided by subsection (4) of this section, if:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 842-250

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- (a) an entity is an \*independent Australian fund manager for the IMR entity; and
  - (b) that entity, or another entity \*connected with the entity, has a direct or indirect right to receive part of the profits of the IMR entity for the year; and
  - (c) the sum of the amounts that the entity, and any other entity connected with the entity, receive for the year in connection with the entity being that independent Australian fund manager exceeds 20% of the amount (the **unadjusted concessional amount**) worked out under subsection (3); and
  - (d) the requirements of subsection 842-215(3) in relation to the year are not met.
- (2) However, this section does not apply if:
- (a) the circumstances giving rise to the requirements of paragraph (1)(c) being met arose outside the control of:
    - (i) the \*IMR entity; or
    - (ii) the \*independent Australian fund manager or any entity \*connected with the independent Australian fund manager; and
  - (b) the independent Australian fund manager, or an entity connected with the independent Australian fund manager, is taking steps to address those circumstances.
- (3) Work out the unadjusted concessional amount as follows:
- $$\begin{array}{rcccl} \text{Amount not} & & \text{Amounts not} & + & \text{Disregarded} & - & \text{Disregarded} \\ \text{assessable} & - & \text{deductible} & & \text{capital gains} & & \text{capital losses} \\ \text{or exempt} & & & & & & \end{array}$$
- where:
- amount not assessable or exempt** is the sum of:
- (a) the amount (the **842-215(1)(a) amount**) of the \*IMR entity's income for the income year that is, or would (apart from this section) be, \*non-assessable non-exempt income of the IMR entity because of paragraph 842-215(1)(a); and
  - (b) the amount (the **842-215(2)(a) amount**) of the IMR entity's income for the income year that is, or would (apart from this

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

section) be, non-assessable non-exempt income of the IMR entity because of paragraph 842-215(2)(a), and not because of paragraph 842-215(1)(a).

***amounts not deductible*** is the amount obtained by adding together:

- (a) the sum of the amounts that are not deductible by the \*IMR entity for the income year because of paragraph 842-215(1)(b); and
- (b) the sum of the amounts that are not deductible by the IMR entity for the income year because of paragraph 842-215(2)(b), and not because of paragraph 842-215(1)(b); and
- (c) the sum of the amounts that would otherwise be deductible by the IMR entity for the income year under section 8-1 if the income in relation to which they were incurred were not income that is \*non-assessable non-exempt income of the IMR entity because of paragraph 842-215(1)(a); and
- (d) the sum of the amounts that would otherwise be deductible by the IMR entity for the income year under section 8-1 if the income in relation to which they were incurred were not income that is non-assessable non-exempt income of the IMR entity because of paragraph 842-215(2)(a), and not because of paragraph 842-215(1)(a).

***disregarded capital gains*** is the amount obtained by adding together:

- (a) the sum (the ***842-215(1)(c) amount***) of the amounts of the \*capital gains that:
  - (i) are from \*CGT events that happen in the income year; and
  - (ii) are, or would (apart from this section) be, disregarded in relation to the \*IMR entity, because of paragraph 842-215(1)(c); and
- (b) the sum (the ***842-215(2)(c) amount***) of the amounts of the capital gains that:
  - (i) are from CGT events that happen in the income year; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**Section 842-250**

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- (ii) are, or would (apart from this section) be, disregarded in relation to the IMR entity because of paragraph 842-215(2)(c), and not because of paragraph 842-215(1)(c).

**disregarded capital losses** is the amount obtained by adding together:

- (a) the sum of the amounts of the \*capital losses that:
    - (i) are from \*CGT events that happen in the income year; and
    - (ii) are disregarded in relation to the \*IMR entity because of paragraph 842-215(1)(c); and
  - (b) the sum of the amounts of the capital losses that:
    - (i) are from CGT events that happen in the income year; and
    - (ii) are disregarded in relation to the IMR entity because of paragraph 842-215(2)(c), and not because of paragraph 842-215(1)(c).
- (4) Apply the sum referred to in paragraph (1)(c) to reduce (including reduce to zero) the following amounts:
- (a) the 842-215(1)(a) amount;
  - (b) the 842-215(2)(a) amount;
  - (c) the 842-215(1)(c) amount;
  - (d) the 842-215(2)(c) amount.
- Do not apply the sum to reduce an amount referred to in a paragraph (other than paragraph (a)) unless the sum has been applied to reduce to zero the amount referred to in each paragraph preceding that paragraph.
- (5) If the 842-215(1)(c) amount or the 842-215(2)(c) amount relates to more than one \*capital gain, a reduction of the amount under subsection (4) is taken to reduce each of the capital gains by the following amount:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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$$\frac{\text{The amount of the reduction under subsection (4)}}{\text{The amount of the *capital gain}} \times \frac{\text{The amount being reduced under subsection (4)}}{\text{The amount being reduced under subsection (4)}}$$

- (6) Without limiting the circumstances in which the requirements of paragraph (1)(c) are not met, those requirements are taken not to be met in relation to the \*IMR entity for an income year if they are not met in relation to the IMR entity for a period (a *qualifying period*) of up to 5 consecutive income years including the income year (but not including any future income years).
- (7) In ascertaining for the purposes of subsection (6) whether the requirements of paragraph (1)(c) are not met in relation to the \*IMR entity for a qualifying period, assume that the qualifying period is the income year referred to in subsection (1).
- (8) For the purposes of paragraphs (1)(b) and (c) (including paragraph (1)(c) as affected by subsections (6) and (7)), disregard any direct or indirect entitlements (including contingent entitlements) of the \*independent Australian fund manager, or any entity \*connected with the independent Australian fund manager, to remuneration from the \*IMR entity:
  - (a) to the extent that the remuneration is subject to income tax in relation to the income year referred to in subsection (1); and
  - (b) to the extent that the remuneration is subject to taxation in relation to that income year under a \*foreign law.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Division 855—Capital gains and foreign residents**

### **Table of Subdivisions**

#### Guide to Division 855

- 855-A Disregarding a capital gain or loss by foreign residents
- 855-B Becoming an Australian resident

### **Guide to Division 855**

#### **855-1 What this Division is about**

A foreign resident can disregard a capital gain or loss unless the relevant CGT asset is a direct or indirect interest in Australian real property, or relates to a business carried on by the foreign resident through a permanent establishment in Australia.

Special rules apply for individuals who were Australian residents but have become foreign residents (see also Subdivision 104-I) and for foreign resident beneficiaries of fixed trusts.

There are also rules dealing with what happens when a foreign resident becomes an Australian resident.

### **Subdivision 855-A—Disregarding a capital gain or loss by foreign residents**

#### **Table of sections**

- 855-5 Objects of this Subdivision
- 855-10 Disregarding a capital gain or loss from CGT events
- 855-15 When an asset is taxable Australian property
- 855-16 Meaning of *permanent establishment article*
- 855-20 Taxable Australian real property
- 855-25 Indirect Australian real property interests
- 855-30 Principal asset test

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- 855-32 Disregard market value of duplicated non-TARP assets
- 855-35 Reducing a capital gain or loss from a business asset—Australian permanent establishments
- 855-40 Capital gains and losses of foreign residents through fixed trusts

### **855-5 Objects of this Subdivision**

- (1) The objects of this Subdivision are to improve:
  - (a) Australia's status as an attractive place for business and investment; and
  - (b) the integrity of Australia's capital gains tax base.
- (2) This is achieved by:
  - (a) aligning Australia's tax laws with international practice; and
  - (b) ensuring interests in an entity remain subject to Australia's capital gains tax laws if the entity's underlying value is principally derived from Australian real property.

### **855-10 Disregarding a capital gain or loss from CGT events**

- (1) Disregard a \*capital gain or \*capital loss from a \*CGT event if:
  - (a) you are a foreign resident, or the trustee of a \*foreign trust for CGT purposes, just before the CGT event happens; and
  - (b) the CGT event happens in relation to a \*CGT asset that is not \*taxable Australian property.

Note: A capital gain or capital loss from a CGT asset you have used at any time in carrying on a business through a permanent establishment in Australia may be reduced under section 855-35.

- (2) The \*CGT asset in relation to which a \*CGT event happens includes the following:
  - (a) for CGT event D1 (about creating contractual or other rights)—the CGT asset that is the subject of the creation of the contractual or other rights;

Example: You grant an easement over land in Australia. The land is the subject of the creation of the rights in the easement. Therefore, the CGT event happens in relation to the land.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) for CGT event D2 (about granting an option)—the CGT asset that is the subject of the option;
- (c) for CGT event F1 (about granting a lease)—the CGT asset that is the subject of the lease;
- (d) for CGT event J1 (about a company ceasing to be a member of wholly-owned group after roll-over)—the roll-over asset.

**855-15 When an asset is taxable Australian property**

There are 5 categories of \*CGT assets that are *taxable Australian property*. They are set out in this table.

<b>CGT assets that are taxable Australian property</b>	
<b>Item</b>	<b>Description</b>
1	*Taxable Australian real property (see section 855-20)
2	A *CGT asset that: <ul style="list-style-type: none"> <li>(a) is an *indirect Australian real property interest (see section 855-25); and</li> <li>(b) is not covered by item 5 of this table</li> </ul>
3	A *CGT asset that: <ul style="list-style-type: none"> <li>(a) you have used at any time in carrying on a *business through: <ul style="list-style-type: none"> <li>(i) if you are a resident in a country that has entered into an *international tax agreement with Australia containing a *permanent establishment article—a permanent establishment (within the meaning of the relevant international tax agreement) in Australia; or</li> <li>(ii) otherwise—a *permanent establishment in Australia; and</li> </ul> </li> <li>(b) is not covered by item 1, 2 or 5 of this table</li> </ul>
4	An option or right to *acquire a *CGT asset covered by item 1, 2 or 3 of this table
5	A *CGT asset that is covered by subsection 104-165(3) (choosing to disregard a gain or loss on ceasing to be an Australian resident)

Note 1: An asset is also taxable Australian property if it was acquired by a company after 28 January 1988 and before 26 May 1988 from a foreign resident as a result of a disposal for which there was a

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

roll-over under section 160ZZN or 160ZZO of the *Income Tax Assessment Act 1936*: see section 136-25 of the *Income Tax (Transitional Provisions) Act 1997*.

Note 2: Payments may need to be made to the Commissioner for acquisitions of some kinds of taxable Australian property if foreign residents are involved (see Subdivision 14-D in Schedule 1 to the *Taxation Administration Act 1953*).

### 855-16 Meaning of *permanent establishment article*

A *permanent establishment article* is:

- (a) Article 5 of the United Kingdom convention (within the meaning of the *International Tax Agreements Act 1953*); or
- (b) a corresponding provision of another \*international tax agreement.

### 855-20 Taxable Australian real property

A \*CGT asset is *taxable Australian real property* if it is:

- (a) real property situated in Australia (including a lease of land, if the land is situated in Australia); or
- (b) a \*mining, quarrying or prospecting right (to the extent that the right is not real property), if the \*minerals, \*petroleum or quarry materials are situated in Australia.

### 855-25 Indirect Australian real property interests

- (1) A \*membership interest held by an entity (the *holding entity*) in another entity (the *test entity*) at a time is an *indirect Australian real property interest* at that time if:
  - (a) the interest passes the \*non-portfolio interest test (see section 960-195):
    - (i) at that time; or
    - (ii) throughout a 12 month period that began no earlier than 24 months before that time and ended no later than that time; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the interest passes the principal asset test in section 855-30 at that time.
- (2) For the purposes of subsection (1), in working out whether the interest passes the \*non-portfolio interest test and the principal asset test in section 855-30:
  - (a) apply section 350 of the *Income Tax Assessment Act 1936* as if the words “, or is entitled to acquire,” (wherever occurring) were omitted; and
  - (b) apply section 351 of that Act as if:
    - (i) the words “, or that the beneficiary is entitled to acquire” (wherever occurring) were omitted; and
    - (ii) the words “, or that the entity is entitled to acquire” in paragraph 351(2)(d) were omitted.
- (3) The first element of the \*cost base and \*reduced cost base of a \*CGT asset on 10 May 2005 is the \*market value of the asset on that day if, on that day:
  - (a) the CGT asset was a \*membership interest you held in another entity; and
  - (b) you were a foreign resident, or the trustee of a trust that was not a \*resident trust for CGT purposes; and
  - (c) the CGT asset was a \*post-CGT asset; and
  - (d) the CGT asset did not have the necessary connection with Australia (within the meaning of this Act as in force on that day) disregarding the operation of paragraph (b) of item 5 and paragraph (b) of item 6 of the table in section 136-25 (as in force on that day).
- (4) Also, Parts 3-1 and 3-3 apply to the asset as if you had \*acquired it on that day.

**855-30 Principal asset test**

- (1) The purpose of this section is to define when an entity’s underlying value is principally derived from Australian real property (see paragraph 855-5(2)(b)).

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (2) A \*membership interest held by an entity (the **holding entity**) in another entity (the **test entity**) passes the principal asset test if the sum of the \*market values of the test entity's assets that are \*taxable Australian real property exceeds the sum of the \*market values of its assets that are *not* taxable Australian real property.

Note: The market value of any of the latter kind of assets that are duplicated within the test entity's corporate group could be disregarded (see section 855-32).

- (3) For the purposes of subsection (2), treat an asset of an entity (the **first entity**) that is a \*membership interest in another entity (the **other entity**) as if it were instead the following 2 assets:
- (a) an asset that is \*taxable Australian real property (the **TARP asset**);
  - (b) an asset that is not taxable Australian real property (the **non-TARP asset**).
- (4) For the purposes of subsection (2), treat the \*market value of the TARP asset and the non-TARP asset according to the following table.

Market value of the TARP asset and the non-TARP asset			
Item	If:	the market value of the TARP asset is:	the market value of the non-TARP asset is:
1	the sum of the *total participation interests held by the holding entity and its *associates in the other entity is less than 10%	zero	the *market value of the *membership interest mentioned in subsection (3)

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Market value of the TARP asset and the non-TARP asset**

Item	If:	the market value of the TARP asset is:	the market value of the non-TARP asset is:
2	item 1 does not apply	the product of: (a) the sum of the *market values of all the assets of the other entity that are *taxable Australian real property; and (b) the first entity's *direct participation interest in the other entity	the product of: (a) the sum of the market values of all the assets of the other entity that are <i>not</i> taxable Australian real property; and (b) the first entity's direct participation interest in the other entity

Note 1: For the purposes of item 2 of the table, it is necessary to work out the market value of any TARP assets and non-TARP assets in relation to any membership interests held by the other entity before working out the value of the TARP asset and non-TARP asset held by the first entity.

Note 2: The market value of an asset of the other entity that is not taxable Australian real property, and is duplicated within the other entity's corporate group, could be disregarded (see section 855-32).

(4A) For the purposes of working out the \*total participation interests held by the holding entity and its \*associates under item 1 of the table in subsection (4), take into account:

(a) a particular \*direct participation interest; or

(b) a particular \*indirect participation interest;

held in the other entity only once if it would otherwise be counted more than once because the entity holding it is an associate of the holding entity.

(5) For the purposes of this section, disregard the \*market value of any asset acquired by the test entity, or by any other entity, if the \*acquisition was done for a purpose (other than an incidental

\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.



purpose) that included ensuring that a \*membership interest in any entity would not pass the principal asset test in this section.

### **855-32 Disregard market value of duplicated non-TARP assets**

- (1) The purpose of this section is to prevent double counting of the \*market value of the assets of a corporate group that:
  - (a) are not \*taxable Australian real property; and
  - (b) are created under \*arrangements under which corresponding liabilities are created in other members of the group.
- (2) For the purposes of subsections 855-30(2) and (4), subsection (4) of this section applies to an asset that is not \*taxable Australian real property if:
  - (a) the parties to an \*arrangement included the 2 entities referred to in subsection (3); and
  - (b) an effect of the arrangement was to create, before the \*CGT event happened:
    - (i) the asset as an asset of one of those 2 parties; and
    - (ii) a corresponding liability of the other (the *other party*).
- (3) The 2 entities are either:
  - (a) the first entity and the other entity (see subsection 855-30(3)), if table item 2 in subsection 855-30(4) applies to those entities; or
  - (b) both:
    - (i) that first entity or that other entity; and
    - (ii) an entity that is a first entity or other entity for the purposes of a related application of subsection 855-30(3) and table item 2 in subsection 855-30(4).
- (4) Disregard:
  - (a) if the other party is the test entity (see subsection 855-30(2))—the asset's \*market value; or

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) otherwise—the percentage of the asset’s market value equal to the percentage that is the test entity’s \*total participation interest in the other party.

Example: The test entity loans money to its wholly-owned subsidiary. The market value of the loan asset created as an asset of the test entity is disregarded for the purposes of subsection 855-30(2).

**855-35 Reducing a capital gain or loss from a business asset—  
Australian permanent establishments**

- (1) This section applies to a \*CGT asset that is \*taxable Australian property under item 3 of the table in section 855-15 because you have used it at any time in carrying on a \*business through a permanent establishment (as mentioned in that item) in Australia.
- (2) The \*capital gain or \*capital loss you make from a \*CGT event in relation to the asset is reduced if you used it in this way for only part of the period from when you \*acquired it to when the CGT event happened.
- (3) The gain or loss is reduced by this fraction:

$$\frac{\text{Number of days the asset was not used in the way described in subsection (1)}}{\text{Number of days in that period}}$$

**855-40 Capital gains and losses of foreign residents through fixed trusts**

- (1) The purpose of this section is to provide comparable taxation treatment as between direct ownership, and indirect ownership through a \*fixed trust, by foreign residents of \*CGT assets that are not \*taxable Australian property.
- (2) A \*capital gain you make in respect of your interest in a \*fixed trust is disregarded if:
  - (a) you are a foreign resident when you make the gain; and

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (b) the gain is attributable to a \*CGT event happening to a \*CGT asset of a trust (the ***CGT event trust***) that is:
  - (i) the \*fixed trust; or
  - (ii) another fixed trust in which that trust has an interest (directly, or indirectly through a \*chain of trusts, each trust in which is a fixed trust); and
- (c) either:
  - (i) the asset is not \*taxable Australian property for the CGT event trust at the time of the CGT event; or
  - (ii) the asset is an interest in a fixed trust and the conditions in subsections (5), (6), (7) and (8) are satisfied.

Note: Section 115-215 treats a portion of a trust's capital gain as a capital gain made by a beneficiary, and applies the CGT discount to that portion as if the gain were made directly by the beneficiary.

- (3) You are not liable to pay tax as a trustee of a \*fixed trust in respect of an amount to the extent that the amount gives rise to a \*capital gain that is disregarded for a beneficiary under subsection (2).
- (4) To avoid doubt, subsection (3) does not affect the operation of subsection 98A(1) or (3) of the *Income Tax Assessment Act 1936* (about taxing beneficiaries who are foreign residents at the end of an income year).

#### *Conditions*

- (5) The conditions in subsections (6), (7) and (8) must be satisfied if the relevant \*CGT event happens to an interest in a \*fixed trust (the ***first trust***) and the interest is \*taxable Australian property at the time of the CGT event.
- (6) At least 90% (by \*market value) of the \*CGT assets of:
  - (a) the first trust; or
  - (b) a \*fixed trust in which the first trust has an interest (directly, or indirectly through a \*chain of trusts, each trust in which is a fixed trust);

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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must not be \*taxable Australian property at the time of the relevant \*CGT event.

- (7) If the condition in subsection (6) is not satisfied for the first trust (but is satisfied for a trust covered by paragraph (6)(b)), the condition in subsection (8) must be satisfied for the first trust, and for each other trust in the \*chain of trusts between the first trust and the trust that satisfied the condition in subsection (6).
- (8) The condition is that, assuming any interest in a \*fixed trust in that \*chain not to be \*taxable Australian property, at least 90% (by \*market value) of the \*CGT assets of the trust must not be taxable Australian property.

**Subdivision 855-B—Becoming an Australian resident**

**Table of sections**

855-45	Individual or company becomes an Australian resident
855-50	Trust becomes a resident trust
855-55	CFC becomes an Australian resident

**855-45 Individual or company becomes an Australian resident**

- (1) If you become an Australian resident, there are rules relevant to each \*CGT asset that you owned just before you became an Australian resident, except an asset:
    - (a) that is \*taxable Australian property; or
    - (b) that you \*acquired before 20 September 1985.
- Note: This section has effect subject to section 768-950 (individuals who become Australian residents and are temporary residents immediately after they become Australian residents).
- (2) The first element of the \*cost base and \*reduced cost base of the asset (at the time you become an Australian resident) is its \*market value at that time.
  - (3) Also, Parts 3-1 and 3-3 apply to the asset as if you had \*acquired it at the time you became an Australian resident.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (4) This section does not apply to an \*ESS interest if:
- (a) Subdivision 83A-C (about employee share schemes) applies to the interest, and the \*ESS deferred taxing point for the interest has not yet occurred; or
  - (b) the provisions referred to in paragraphs 83A-33(1)(a) to (c) (about start ups) apply to the ESS interest.

### **855-50 Trust becomes a resident trust**

- (1) If a trust becomes a \*resident trust for CGT purposes, there are rules relevant to each \*CGT asset that the trustee owned just before the trust became a resident trust for CGT purposes, except one:
- (a) that is \*taxable Australian property; or
  - (b) that the trustee \*acquired before 20 September 1985.
- (2) The first element of the \*cost base and \*reduced cost base of the asset (at the time the trust becomes a \*resident trust for CGT purposes) is its \*market value at that time.
- (3) Also, Parts 3-1 and 3-3 apply to the asset as if the trustee had \*acquired it at the time the trust became a \*resident trust for CGT purposes.

#### *Exception*

- (4) This section does not apply to a trust if, just before it became a \*resident trust for CGT purposes, it was a \*CFT because of paragraph 342(a) of the *Income Tax Assessment Act 1936*.

Note: This section is disregarded in calculating the attributable income of a trust: see section 102AAZB of the *Income Tax Assessment Act 1936*.

### **855-55 CFC becomes an Australian resident**

- (1) This section applies to a \*CFC that stops at a time (the ***residence change time***) being a resident of a \*listed country or an \*unlisted country and becomes an Australian resident.
- (2) Section 855-45 does not apply to the \*CFC.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Section 855-55**

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- (3) The modifications of Parts 3-1 and 3-3 of this Act in sections 411 to 414 of the *Income Tax Assessment Act 1936* have the effect they would have, in relation to each \*commencing day asset owned by the \*CFC at the residence change time, if those modifications were used to work out the taxable income of the CFC rather than its \*attributable income.
- (4) However, if a \*capital gain on a \*commencing day asset of the \*CFC (for a period before the residence change time) was \*subject to foreign tax in a \*listed country, the modifications of Parts 3-1 and 3-3 of this Act in sections 411 to 414 of the *Income Tax Assessment Act 1936* have the effect they would have in relation to the asset if:
- (a) those modifications were used to work out the taxable income of the CFC rather than its \*attributable income; and
  - (b) the \*commencing day of the CFC were the residence change time.

Note: This section is disregarded in calculating the attributable income of a CFC: see section 410 of the *Income Tax Assessment Act 1936*.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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## **Division 880—Sovereign entities and activities**

### **Table of Subdivisions**

880-A	Basic concepts
880-B	Basic tax treatment of sovereign entities
880-C	Sovereign immunity
880-D	Consular activities

### **Subdivision 880-A—Basic concepts**

#### **Guide to Subdivision 880-A**

#### **880-10 What this Subdivision is about**

This Subdivision defines several terms that are fundamental to the operation of this Division, such as *sovereign entity* and *sovereign entity group*.

#### **Table of sections**

##### **Operative provisions**

880-15	Meaning of <i>sovereign entity</i>
880-20	Meaning of <i>sovereign entity group</i>

### **Operative provisions**

#### **880-15 Meaning of *sovereign entity***

A *sovereign entity* is any of the following:

- (a) a body politic of a foreign country, or a part of a foreign country;
- (b) a \*foreign government agency;
- (c) an entity:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 880-20

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- (i) in which an entity covered by paragraph (a) or (b) holds a \*total participation interest of 100%; and
- (ii) that is *not* an Australian resident; and
- (iii) that is *not* a resident trust estate for the purposes of Division 6 of Part III of the *Income Tax Assessment Act 1936*.

**880-20 Meaning of *sovereign entity group***

- (1) Each of the following is part of a ***sovereign entity group***:
  - (a) a body politic of a foreign country (other than a body politic of a part of that foreign country);
  - (b) a \*foreign government agency in relation to that foreign country (other than a foreign government agency in relation to a part of that foreign country);
  - (c) an entity:
    - (i) in which an entity covered by paragraph (a) or (b) holds a \*total participation interest of 100%; and
    - (ii) that is *not* an Australian resident; and
    - (iii) that is *not* a resident trust estate for the purposes of Division 6 of Part III of the *Income Tax Assessment Act 1936*.
- (2) Each of the following is part of a ***sovereign entity group***:
  - (a) a body politic of a part of a foreign country;
  - (b) a \*foreign government agency in relation to that part of that foreign country;
  - (c) an entity:
    - (i) in which an entity covered by paragraph (a) or (b) holds a \*total participation interest of 100%; and
    - (ii) that is *not* an Australian resident; and
    - (iii) that is *not* a resident trust estate for the purposes of Division 6 of Part III of the *Income Tax Assessment Act 1936*.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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- (3) Each entity that is part of a \*sovereign entity group is a *member* of the group.

## **Subdivision 880-B—Basic tax treatment of sovereign entities**

### **Guide to Subdivision 880-B**

#### **880-50 What this Subdivision is about**

This Subdivision provides that a sovereign entity is liable to pay tax. It also provides that a body politic (or a foreign government agency) of a foreign country, or part of a foreign country, is treated as being a person that is not a resident of Australia, but is a resident of the foreign country.

#### **Table of sections**

##### **Operative provisions**

880-55	Sovereign entity liable to pay tax
880-60	Bodies politic of foreign countries and foreign government agencies treated as foreign residents

#### **Operative provisions**

##### **880-55 Sovereign entity liable to pay tax**

A \*sovereign entity is liable to pay \*tax.

Note: The actual amount of tax payable may be nil.

##### **880-60 Bodies politic of foreign countries and foreign government agencies treated as foreign residents**

- (1) For the purposes of this Act, treat a body politic of a foreign country, or a part of a foreign country:
- (a) as being a person that is not a resident of Australia; and
  - (b) as being a resident of the foreign country.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 880-100

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- (2) For the purposes of this Act, treat a \*foreign government agency in relation to a foreign country (including a foreign government agency in relation to a part of a foreign country):
- (a) as being a person that is not a resident of Australia; and
  - (b) as being a resident of the foreign country.

**Subdivision 880-C—Sovereign immunity**

**Guide to Subdivision 880-C**

**880-100 What this Subdivision is about**

This Subdivision provides a tax exemption for certain sovereign entities in respect of certain returns on membership interests (etc.) in entities that are Australian resident companies or managed investment trusts. To obtain this exemption, the relevant sovereign entity group can hold only a portfolio interest in the entity, and cannot have relevant influence over the entity.

**Table of sections**

**Operative provisions**

880-105	Sovereign entity's income from membership interest etc. in trust or company—non-assessable non-exempt income
880-110	Sovereign entity's deduction from membership interest etc.—loss not deductible
880-115	Sovereign entity's capital gain from membership interest etc.—gain disregarded
880-120	Sovereign entity's capital loss from membership interest etc. in trust or company—loss disregarded
880-125	Covered sovereign entities
880-130	Meaning of <i>public non-financial entity</i> and <i>public financial entity</i>

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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**Operative provisions****880-105 Sovereign entity's income from membership interest etc. in trust or company—non-assessable non-exempt income**

- (1) An amount of \*ordinary income or \*statutory income of a \*sovereign entity is not assessable income and is not \*exempt income if:
- (a) the sovereign entity is covered by section 880-125; and
  - (b) the amount is a return on any of the following kinds of interest that the sovereign entity holds in another entity (the **test entity**):
    - (i) a \*membership interest;
    - (ii) a \*debt interest;
    - (iii) a \*non-share equity interest; and
  - (c) the test entity is:
    - (i) a company that is an Australian resident at the time (the **income time**) when the amount becomes ordinary or statutory income of the sovereign entity; or
    - (ii) a \*managed investment trust in relation to the income year in which the income time occurs; and
  - (d) the \*sovereign entity group of which the sovereign entity is a member satisfies the portfolio interest test in subsection (4) in relation to the test entity:
    - (i) at the income time; and
    - (ii) throughout any 12 month period that began no earlier than 24 months before that time and ended no later than that time; and
  - (e) the sovereign entity group of which the sovereign entity is a member does not have influence of a kind described in subsection (6) in relation to the test entity at the income time.
- (2) For the purposes of paragraph (1)(b), treat an interest that a \*sovereign entity holds in another entity as a partner in a \*partnership as not being an interest that the sovereign entity holds in the other entity.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 880-105

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- (3) If the amount is a \*fund payment, subsection (1) does not apply to the extent that the amount is attributable to:
- (a) \*non-concessional MIT income (see section 12-435 in Schedule 1 to the *Taxation Administration Act 1953*); or
  - (b) an amount that would be non-concessional MIT income if the following provisions were disregarded:
    - (i) subsection 12-437(5) in that Schedule;
    - (ii) sections 12-440, 12-447, 12-449 and 12-451 in that Schedule.

*Portfolio interest test*

- (4) A \*sovereign entity group satisfies the portfolio interest test in this subsection in relation to the test entity at a time if, at that time, the sum of the \*total participation interests that each \*member of the group holds in the test entity:
- (a) is less than 10%; and
  - (b) would be less than 10% if, in working out the \*direct participation interest that any entity holds in a company:
    - (i) an \*equity holder were treated as a shareholder; and
    - (ii) the total amount contributed to the company in respect of \*non-share equity interests were included in the total paid-up share capital of the company.
- (5) For the purposes of subsection (4), in working out the sum of the \*total participation interests held by each \*member of the group in the test entity, take into account:
- (a) a particular \*direct participation interest; or
  - (b) a particular \*indirect participation interest;
- held in the entity only once if it would otherwise be counted more than once.

*Influence test*

- (6) A \*sovereign entity group has influence of a kind described in this subsection in relation to the test entity at a time if any of the following requirements are satisfied at that time:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

- (a) a \*member of the group:
  - (i) is directly or indirectly able to determine; or
  - (ii) in acting in concert with others, is directly or indirectly able to determine;  
the identity of at least one of the persons who, individually or together with others, make (or might reasonably be expected to make) the decisions that comprise the control and direction of the test entity's operations;
- (b) at least one of those persons is accustomed or obliged to act, or might reasonably be expected to act, in accordance with the directions, instructions or wishes of a member of the group (whether those directions, instructions or wishes are expressed directly or indirectly, or through the member acting in concert with others).
- (7) However, a \*sovereign entity group does not have influence of a kind described in subsection (6) if, disregarding any breach of terms of a \*debt interest by any entity, the sovereign entity group would not have influence of that kind.
- (8) For the purposes of subsection (6), in working out whether an entity is a \*member of a \*sovereign entity group, treat the references in paragraphs 880-20(1)(c) and (2)(c) to 100% as instead being references to more than 50%.

**880-110 Sovereign entity's deduction from membership interest etc.—loss not deductible**

A \*sovereign entity cannot deduct an amount if:

- (a) the sovereign entity is covered by section 880-125; and
- (b) the amount is a loss in respect of any of the following kinds of interest that the sovereign entity holds in another entity:
  - (i) a \*membership interest;
  - (ii) a \*debt interest;
  - (iii) a \*non-share equity interest; and
- (c) the requirements in paragraphs 880-105(1)(c), (d) and (e) would be satisfied, on the assumptions that:

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

Section 880-115

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- (i) the amount were \*ordinary income or \*statutory income; and
- (ii) the amount became ordinary income or statutory income of the sovereign entity at the time it arose; and
- (iii) references in those paragraphs to the test entity were references to the other entity mentioned in paragraph (b) of this section.

**880-115 Sovereign entity's capital gain from membership interest etc.—gain disregarded**

Disregard a \*capital gain of a \*sovereign entity from a \*CGT event that happens in relation to a \*CGT asset if:

- (a) the sovereign entity is covered by section 880-125; and
- (b) the CGT asset is a \*membership interest, \*non-share equity interest or \*debt interest in another entity; and
- (c) the requirements in paragraphs 880-105(1)(c), (d) and (e) would be satisfied, on the assumptions that:
  - (i) the capital gain were an amount of \*ordinary income or \*statutory income; and
  - (ii) the amount mentioned in subparagraph (i) became ordinary income or statutory income of the sovereign entity immediately before the time the CGT event happened; and
  - (iii) references in those paragraphs to the test entity were references to the other entity mentioned in paragraph (b) of this section.

**880-120 Sovereign entity's capital loss from membership interest etc. in trust or company—loss disregarded**

Disregard a \*capital loss of a \*sovereign entity from a \*CGT event that happens at a time if, on the assumption that the loss were a \*capital gain that happened at that time, the capital gain would be disregarded because of section 880-115.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

**880-125 Covered sovereign entities**

A \*sovereign entity is covered by this section if it satisfies all of the following requirements:

- (a) the entity is funded solely by public monies;
- (b) all returns on the entity's investments are public monies;
- (c) the entity is *not* a partnership;
- (d) the entity is *not* any of the following:
  - (i) a \*public non-financial entity;
  - (ii) a \*public financial entity (other than a public financial entity that only carries on central banking activities).

**880-130 Meaning of *public non-financial entity* and *public financial entity***

- (1) An entity is a ***public non-financial entity*** if its principal activity is either or both of the following:
  - (a) producing or trading non-financial goods;
  - (b) providing services that are not financial services.
- (2) An entity is a ***public financial entity*** if any of the following requirements are satisfied:
  - (a) it trades in financial assets and liabilities;
  - (b) it operates commercially in the financial markets;
  - (c) its principal activities include providing any of the following financial services:
    - (i) financial intermediary services, including deposit-taking and insurance services;
    - (ii) financial auxiliary services, including brokerage, foreign exchange and investment management services;
    - (iii) capital financial institution services, including financial services in relation to assets or liabilities that are not available on open financial markets.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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Section 880-200

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**Subdivision 880-D—Consular activities**

**Guide to Subdivision 880-D**

**880-200 What this Subdivision is about**

This Subdivision provides a tax exemption for income of an entity that arises from its consular functions.

**Table of sections**

**Operative provisions**

880-205 Income from consular functions—non-assessable non-exempt income

**Operative provisions**

**880-205 Income from consular functions—non-assessable non-exempt income**

An amount of \*ordinary income or \*statutory income of an entity is not assessable income and is not \*exempt income if the income arises from the entity's consular functions.

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\*To find definitions of asterisked terms, see the Dictionary, starting at section 995-1.

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